

COMMERCIAL LAW IN THE CRACKS OF JUDICIAL FEDERALISM

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Almost seventy years after the Supreme Court sought to rationalize the American system of judicial federalism in *Erie*, sales law remains trapped in a pattern more reminiscent of the *Swift v. Tyson* era. The extraordinarily wide separation of powers in the NCCUSL-ALI uniform law-making process has entrenched Article 2 of the UCC in the status quo. Concurrently, an imbalance between the federal and state courts in the American system of judicial federalism has conferred an unusually wide range of discretion over state commercial law on the federal courts. Ironically, therefore, state sales statutes are being reinterpreted and revised by the federal courts rather than the state legislatures or state courts. The federal courts are thus the most important source of innovation and experimentation in modern American sales law, but the role they play is not entirely consistent with modern notions of democracy and judicial restraint. Moreover, it is debatable whether they have, in exercising their discretion, brought much rationality and coherence to the law or simply injected uncertainty and disharmony instead. At this point it appears that the pattern will persist. Thus, it seems inevitable that American sales law will continue to diverge, not only across jurisdictions but further and further away from the rickety framework of Article 2. American sales law therefore will not only continue to devolve into something more akin to the common law, it will remain an area of disjunction in which the federal courts play the dominant role in developing the law, even though the law is still formally within the authority of the states.

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INTRODUCTION

Modern American sales law is rife with controversy.¹ There is an ongoing debate about such fundamental matters as the scope of Article 2, the rules governing the formation of sales contracts, the dearth of consumer protections, and the role of the federal courts in construing the law.² The recent attempts to revise Article 2 have thus far ended in failure, and at this point it remains unclear whether sales law in the United States will remain uniform in the years ahead.³ Other authors have attributed the current dilemma to the commercial law-making process.⁴ While this article fully concurs, it argues that the deficiencies in the commercial law-making process are deeply rooted in the peculiarities of American judicial federalism. The wide separation of powers over the enactment of new commercial law statutes together with an imbalance in the structure of American judicial federalism have left Article 2 of the Uniform Commercial Code (UCC) deeply entrenched in the status quo while at the same time conferring an unusually wide range of discretion on the federal courts over the interpretation of state sales statutes.⁵ As a consequence, American sales law is being reinterpreted and revised not through the uniform law-making process but through the decisions of the federal courts.

¹ This was reflected in the title and subject of the recent Association of American Law Schools Conference on Commercial Law at the Crossroads, June 14-17, 2005 held in Montreal, Canada.

² See the discussion *infra* part III.

³ Some prominent scholars have expressed skepticism. See, e.g., Robert E. Scott, *The Rise and Fall of Article 2*, 62 LA.L REV. 1009 (2002).

⁴ *Id.* See also, Allan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U.P.A.L.REV. 585, 639 (1995).

⁵ See the discussion *infra* part II.

From a long-run perspective, what matters most is not so much the substance of the law itself at any point in time as the mechanisms for adapting and revising it in the face of the new problems and pressures created by social and economic changes.⁶ As a general matter, the law can be revised through the enactment of new statutes or through the decisions of courts. In a federal system of government such as in the one in the United States new statutes can be enacted at the federal or state levels and decisions can be made by both federal and state courts. The Constitution of the United States clearly assigns the authority to enact statutes in certain areas of the law to the federal government and leaves other areas to the states.⁷ The scope of federal authorities has expanded quite significantly over time, however, both because of underlying social and economic changes and because the Supreme Court has tended to interpret the federal authorities more broadly (perhaps because of the underlying social and economic changes).⁸ Consequently, most commercial law today is within the scope of the federal government's constitutional authority over interstate commerce, yet, for historical reasons, most commercial law statutes are still enacted by state legislatures. It is ironic, therefore, that the most important source of innovation and change in modern American sales law is from federal court decisions that reinterpret the state statutes.

⁶ This is one of the main themes and concerns of new institutionalist economic historians, such as Douglas North, Gary Libecap, and Lee Alston. See, e.g., DOUGLAS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE (1990).

⁷ U.S. CONST. art. I, § 8, cl. 3.

⁸ This has occurred most notably through an expansion in the federal government's commerce clause powers. See GEOFFREY R. STONE, LOUIS M. SEIDMAN, CASS R. SUSTEIN, AND MARK V. TUSHNET, CONSTITUTIONAL LAW, 189-233 ((1996) for an overview.

It is not, however, without historical precedent. Indeed, the federal courts frequently sought to fashion general rules of commercial law that often departed from the state common law throughout the nineteenth and well into the twentieth centuries. The Supreme Court gave its imprimatur to their efforts in *Swift v. Tyson*.⁹ Unfortunately, the federal courts' efforts failed to bring rationality and uniformity to American commercial law and merely exacerbated forum-shopping and all its injustices instead. The Supreme Court ultimately overruled *Swift v. Tyson* in *Erie v. Tompkins*¹⁰ and held that the federal courts must follow state court precedents on questions of state law. *Erie* purported to bring an end to an era in which the federal courts sought to develop a body of general common law. As other scholars have documented, it was at best a mixed success.¹¹ It is widely acknowledged that the federal courts continue to develop a body of general common law through their interpretations of federal statutes.¹²

It is much less widely acknowledged, however, that the federal courts continue to play an important role in the development of state law, especially state commercial law. Indeed, the federal courts continue to render holdings on questions of state law that sometimes clearly contradict state statutes and state court precedents and that subsequently influence the development of state law.¹³ Nowhere is this more glaringly

⁹ *Swift v. Tyson*, 41 U.S. 1 (1842).

¹⁰ *Erie v. Tompkins*, 304 U.S. 64 (1938).

¹¹ See, e.g., Louise Weinberg, *Federal Common Law* 83 NW.U.L. REV. 805 (1989) and Caleb Nelson, *The Persistence of General Law*, 105 COLUM.L.REV. 503 (2006).

¹² *Id.*

¹³ Thus, the federal courts play an important role in the development of state common law generally. As G. ALAN TARR & MARY CORNELIA PORTER, STATE SUPREME COURTS IN STATE AND

apparent than in the field of sales law. Ironically, in spite of all of the lofty ideals of judicial federalism that the Supreme Court laid out in *Erie*, commercial law – and sales law in particular -- remains rooted in the *Swift* era.¹⁴ *Erie* may have clarified that the federal courts are supposed to abide by state court precedents on questions of state law, but the federal courts continue to exercise almost unbridled discretion over the interpretation of state commercial law statutes, in some cases rendering holdings that clearly contradict the statutes in their efforts to bring rationality and coherence to modern American sales law.¹⁵

The first part of this article offers an overview of modern developments in American judicial federalism and argues that it has left an imbalance in the relative powers of the federal and state courts. The second part draws on the comparative institutional analysis of the separation of powers in a Constitutional democracy to explain how this imbalance in American judicial federalism has resulted in the federal courts having far more discretion over the interpretation of state laws than the state courts, particularly within the sphere of commercial law. On the one hand, this means that the federal courts have been an important source of experimentation and innovation in the law at a time when new technologies and commercial practices have created pressures for significant legal reform; on the other hand, it also means that the federal courts are

NATION, 20 (1988) observe, “Despite the U.S. Supreme Court’s decision in 1938 overruling *Swift*, the impact of federal courts on the common law has continued.... Because federal courts confront common law issues, they contribute to the development of the common law, and state courts may draw upon their rulings in enunciating common law principles.”

¹⁴ See the discussion *infra* parts II and III.

¹⁵ See the discussion *infra* parts II and III.

playing a far more prominent role in the process of reforming commercial law than either the state courts or the state legislatures. The third part illustrates the consequences by examining three prominent areas of controversy in modern sales law that have arisen from the federal courts' exercise of their judicial discretion. As the discussion elaborates, the federal courts have been at the heart of debates about computer software and the scope of Article 2, the rules governing the formation of sales contracts, and the consequences of the failure of limited remedy clauses. The final section concludes.

I. THE AMERICAN SYSTEM OF JUDICIAL-FEDERALISM

Erie was a pivotal case. It shifted the fault lines in the American system of judicial federalism and stymied a burgeoning body of federal common law,¹⁶ which was already beginning to spawn an unwholesome degree of forum shopping by the early twentieth century.¹⁷ The Supreme Court has subsequently worked out an important body of jurisprudence governing the appropriate choice between federal and state rules in federal diversity cases and state cases arising under federal law. It is now clear that federal courts are supposed to apply state statutes and precedents when answering

¹⁶ This is not to deny that the federal courts still create federal common law through their interpretations of federal statutes or that they still play an important role in interpreting state law. See Weinberg, *supra* note 11 and Nelson, *supra* note 11 for an overview of federal common law in the post-*Erie* era.

¹⁷ This was cited by the Court in *Erie*. As Justice Brandeis wrote, “*Swift v. Tyson* introduced grave discrimination by non-citizens against citizens. It made rights enjoyed under the unwritten “general law” vary according to whether enforcement was sought in the state or the federal court; and the privilege of selecting the court in which the right should be determined was conferred upon the non-citizen....The discrimination resulting became in practice far-reaching.” *Erie*, 304 U.S. at 74-75.

questions that arise under state law and state courts must follow federal statutes and precedents when answering questions that arise under federal law.¹⁸ There are, in addition, sophisticated tests for making the appropriate choices of law when procedural questions bear on substantive legal outcomes.¹⁹

¹⁸ IRWIN CHEMERINSKY, *FEDERAL JURISDICTION* 266-67 (1989) has summarized the Court's jurisprudence as follows: "if state and federal law are inconsistent, the following questions must be asked. First, is there a valid federal statute or Federal Rule of procedure on point....If so, then the federal law is to be applied, even if there is a conflicting state law. If there is not a valid [Federal] statute or Rule of procedure, the second question is whether the application of the state law in question is likely to be determinative of the outcome of the lawsuit. If the state law is not outcome determinative, then federal law is used. But if the state law is deemed to be outcome determinative, then the third question is asked: is there an overriding federal interest justifying the application of federal law?"

¹⁹ In addition to *Erie*, the Court has developed a series of tests to answer complicated questions that arise when federal courts must decide whether to follow federal or state procedures in diversity cases. In an early case, *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945) (in diversity cases the outcome of the litigation should be substantially the same as if tried in a state court), the Court proposed an "outcome-determinative" test. In subsequent cases, especially *Byrd v. Blue Ridge Rural Electric Cooperative*, 356 U.S. 525 (1958) (if the state practice is bound up with the definition of the rights and obligations of the parties a federal court should follow state practice; if not, a federal court may follow federal practice if there are affirmative countervailing considerations of federal judicial administration), and *Hanna v. Plummer*, 380 U.S. 460 (1965) (in the absence of a federal rule or statute, a federal court should follow the state practice if following the federal practice would lead to forum-shopping or inequitable administration of the laws), the Court has modified *Guaranty Trust* and developed a multilayered approach that inquires first into the existence of relevant federal procedural rules and then applies a modified outcome-determinative test. For a summary, see *Id.*

The case law since *Erie* has thus constructed a framework within which fundamental questions about the roles of the federal and state courts can be answered. In spite of all the nuances of this sophisticated jurisprudential edifice, however, there is still a gaping crack in its foundations. If a state court incorrectly applies federal law the losing party can in theory appeal the decision all the way to the Supreme Court of the United States, and the Supreme Court therefore has ultimate authority over all questions arising under federal law; if a federal court incorrectly applies state law in a diversity case, however, the losing party has no right of appeal to the state supreme court, and the state supreme courts do not, therefore, have ultimate authority over all questions arising under state law.²⁰ Of course, the federal courts are obliged to follow state statutes and precedents, and if novel questions arising under state law come before them they are supposed to predict how the state supreme court would respond.²¹ Moreover, some states

²⁰ The state courts might have the opportunity to overrule a federal holding on a question of state law if the same question happens to subsequently come before them. Although that has happened, it is far from likely and will not necessarily result in a reopening of the case. It did result in a reopening of the case in *Pierce v. Cook & Co.*, 518 F.2d 720 (10th Cir. 1975) (for a discussion, see Note, *Pierce v. Cook: Rule 60(b)(6) Relief from Judgment for Change of State Law in a Diversity Case*, 62 VA. L. REV. 414 (1976) and Note, *Federal Rule of Civil Procedure 60(b): Standards for Relief from Judgments Due to Changes in Law*, 43 U. CHI. L. REV. 646 (1976), but in some other cases, such as *DeWeerth v. Baldinger*, 38 F.3d 1266 (2d Cir. 1994) it did not. Some states allow federal courts to certify questions of state law to the state supreme court for an answer, but this procedure is not always available and there is no requirement that the federal courts must take advantage of it even if it is. For a discussion, see STEPHEN C. YEAZELL, *CIVIL PROCEDURE* 288-92 (1996).

²¹ The Supreme Court has held that a federal court may not decline to hear a case simply because of uncertainty as to the relevant state law. *Meredith v. Winter Haven*, 320 U.S. 228, 236, 238 (1943). In

allow federal courts to certify questions to the state supreme court for definitive interpretations of state law.²² But in practice, the imbalance has given the federal courts degrees of freedom in interpreting state law that the state courts do not have in interpreting federal law.²³ This has had especially significant consequences for recent developments in commercial law, and lies at the heart of the controversy over recent attempts to amend Article 2 of the UCC.

It is easy to forget that *Swift v. Tyson* was a commercial law case. Under the doctrine the Supreme Court established in *Swift*, the federal courts sought to achieve uniformity in commercial law through holdings that looked beyond the narrow provincialism of any one state's laws.²⁴ In this regard, their decisions reflected the

Commissioner v. Estate of Bosch, 387 U.S. 456, 465 (1965) the Court stated that “If there be no decision by [the state supreme court] then federal authorities must apply what they find to be the state law after giving proper regard to relevant rulings of other courts in the state. In this respect, it may be said to be, in effect, sitting as a state court.” This peculiar arrangement invited the following quip by Judge Friendly in *Nolan v. Transocean Air Lanes*, 276 F.2d 280, 281 (2d Cir. 1960)), a case that raised a difficult question about the choice of state law in a federal diversity case: “Our principal task is to determine what the New York courts would think the California courts would think on an issue about which neither has thought.”

²² About half the states allow certification. For a discussion, see PETER W. LOW & JOHN C. JEFFRIES, *FEDERAL COURTS AND THE LAW OF FEDERAL-STATE RELATIONS* 307 (1994).

²³ The losing party in a federal diversity case could always appeal to the Supreme Court on the grounds that the federal court's interpretation of state law violated *Erie*, but the Supreme Court would be extremely unlikely to grant a writ of certiorari in such a case.

²⁴ In *Swift*, the Court held that the section of the Judiciary Act that directed the federal courts to look to “the laws of the several states” for legal authorities in diversity cases was meant to be “strictly limited to local statutes and local usages” and that it did not extend to “contracts and other instruments of a commercial nature, the true interpretation and effect whereof are to be sought not in the decisions of the local tribunals,

dominant jurisprudential tradition of the time. Under the theory of natural law that prevailed during the antebellum period, certain legal principles were thought to transcend jurisdictional boundaries and provide rules of law common to all courts in all jurisdictions.²⁵ This was especially true in the area of commercial law, which was thought to be rooted in the ancient law of the merchant and governed by usage of trade and underlying principles of commerce.²⁶ In appealing to these broader authorities, federal judges simply believed they were constructing their interpretations of the law correctly, rather than devising a separate body of federal commercial law.²⁷ Indeed, there was an understanding of the great value of uniformity in commercial laws implicit in their appeal to these broader principles.²⁸ When federal courts rendered holdings that

but in the general principles and doctrines of commercial jurisprudence” *Swift*, 41 U.S. at 19. The doctrine was subsequently extended to questions in tort in *Baltimore & Ohio RR. V. Baugh*, 149 U.S. 368 (1893) and to questions in property in *Kuhn v. Fairmont Coal Co.*, 215 U.S. 349 (1910) but it is significant that it arose out of a case in commercial law.

²⁵ The medieval conception of natural law, which was based on the “premise that any positive law that violated natural law was void,” had long since been marginalized. MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW*, 156 1870-1960. In the Classical legal jurisprudence that emerged in the nineteenth century “natural rights discourse structured legal argument by suggesting starting points, background assumptions, presumptions, or first principles in the law.” *Id.* at 158.

²⁶ The great British jurist, Lord Mansfield attempted to institutionalize the reference to mercantile custom by relying on a jury of merchants. HOLDSWORTH, *SOME MAKERS OF ENGLISH LAW*, 160-175 (1938). According to Karl Llewellyn, *Across Sales on Horseback*, 52 HARV.L.REV. 725 (1939), however, the law of sales never fully incorporated mercantile custom.

²⁷ As Weinberg, *supra* note 11 at 824 put it, in *Swift* Justice Story “was aiming for uniform commercial law – and better commercial law than he found under the ...common law of New York.”

²⁸ *Id.*

rejected or ignored state court holdings they were trying to achieve legal unification through the development of a system of “general commercial law” that cohered with the underlying principles of commercial transactions.²⁹

Federal court holdings on state questions that clearly diverged from state authorities were not, however, consistent with twentieth century theories of democracy and judicial restraint.³⁰ Indeed, the current imbalance in judicial federalism is also inconsistent with fundamental principles of democracy and judicial restraint, since it allows federal courts to render holdings on state questions that are not subject to a right of appeal to the state supreme courts. This places them beyond the system of checks and balances that normally helps to ensure judicial accountability and restrain the scope of judicial discretion in a constitutional democracy.³¹ The federal courts have exercised

²⁹ Justice Story, who wrote the Court’s opinion in *Swift*, had earlier been an advocate of legal codification in Massachusetts. See Gunther A. Weiss, *The Enchantment of Codification in the Common-Law World* 25 YALE J.INT.L 435 (2000). In *Swift*, 41 U.S. at 18 Story held that federal courts could declare rules for “general commercial law” in a manner consistent with Lord Manfield’s dictum that commercial law is “not the law of a single country only, but of the commercial world.” As Weinberg, *supra* note 11 at 824 observed, “Story hoped ...that uniformity would follow.”

³⁰ As Justice Brandeis noted in *Erie*, 304 U.S. at 72, “The federal courts [under *Swift*] assumed, in the broad field of general law, the power to declare rules of decision which Congress was confessedly without power to enact as statutes.” At least until some time in the twentieth century, it was clear that the federal government’s commerce powers did not extend to all commercial activities. Nonetheless, *Swift* authorized the federal courts to create general commercial law without regard to the scope of federal commerce powers. This was the unconstitutional course of conduct authorized by *Swift* to which Brandeis alluded in *Erie*. *Id.* at 77-78.

³¹ See the discussion *infra*, section II.

their discretion quite freely, particularly in interpreting Article 2.³² While this has promoted experimentation and innovation in the law and militated against legal obsolescence, it has also begun to undermine the uniformity of American sales law.³³

II. THE SEPARATION OF POWERS AND THE SCOPE OF JUDICIAL DISCRETION

A. Comparative Institutional Analysis

In any constitutional democracy some degree of discretion must be accorded to the judiciary. There can be no rule of law unless the courts have the authority to interpret statutes and precedents free from the control of political officials.³⁴ Yet if the courts were

³² See the discussion *infra*, in section III.

³³ Justice Brandeis cited the failure of the *Swift* doctrine to achieve uniformity in *Erie* 304 U.S. at 74: “Persistence of state courts in their own opinions on questions of common law prevented uniformity; and the impossibility of discovering a satisfactory line of demarcation between the province of general law and that of local law developed a new well of uncertainties.” Indeed, divergent judicial decisions have frustrated the objectives of commercial codification since the turn-of-the-twentieth century. See WALTER P. ARMSTRONG, A HISTORY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 50 (1991). The argument below suggests, however, that the inordinate discretion of the federal courts on questions of state law has created very particular problems for the development of sales law.

³⁴ See ROBERT COOTER, THE STRATEGIC CONSTITUTION 211-39, 365-367 (2000) for an overview. As Cooter notes, the system of justice in a dictatorship, such as the former Soviet Union, has been referred to as “telephone justice,” presumably to invoke the metaphor of the executive telephoning a judge to direct her disposition of a case. *Id.*

granted complete autonomy to interpret the laws without any checks against their exercise of discretion or any system of judicial accountability, they could fashion the laws without regard to the will of the electorate, and the rule of law could become little more than a façade for totalitarianism.³⁵ The framers of the U.S. Constitution thought very carefully about the role of the judiciary as well as the legislative and executive branches of government, and sought to restrain the power of each through a well-defined system of checks and balances.³⁶ Indeed, the system of government the framers devised was a creative and original response to the potential pitfalls in a republican form of

³⁵ In a true theocracy, for instance, there is no separation of powers and all branches of government are subordinate to the law of the prevailing religion. A theocracy may, therefore, veer towards a kind of totalitarianism in which the people are subordinate to the legal dictates of their religious leaders. Indeed, MANFRED HALPERN, *THE POLITICS OF SOCIAL CHANGE IN THE MIDDLE EAST AND NORTH AFRICA* 134-155 ((1963) coined the term “neo-Islamic totalitarianism” to refer to the Muslim fundamentalist forces at play in the Middle East over forty years ago. That characterization has been challenged (see e.g. Michael Whine, *Islamimism and Totalitarianism: Similarities and Differences*, 2 *TOTALITARIAN MOVEMENTS AND POLITICAL RELIGIONS* 54 (2001)) but, in light of recent experience in the Middle East, particularly in Afghanistan under the Taliban regime, the analogy remains highly relevant.

³⁶ William Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 *J.L. & ECON.* 875 (1975) argue that an independent and neutral judiciary is essential to enforcing the bargains between competing interests in the democratic process. From the perspective offered here, it is naive to think that the judiciary can be truly independent and neutral. Indeed, the separation of powers between the executive and legislative branches inevitably confers political power on the judiciary. As long as the judicial appointment process is subject to political control, therefore, it will be impossible for the judiciary to remain truly independent and neutral.

government. In that regard, the U.S. Constitution was an experiment in democracy as well as the product of political theory and compromise.³⁷

The U.S. Constitution thus provides a useful model for understanding the role of the judiciary in a constitutional democracy. The framers invested legislative powers in the Congress, but divided them between the House of Representatives and the Senate.³⁸ Moreover, the President was given the power to veto new legislation, subject to a two thirds majority override;³⁹ this veto provision confers some de facto legislative power on the executive branch of government as well as the legislature. Any new legislation requires a bargain -- a bargain between both Houses of Congress as well as the

³⁷ The actual history of the Constitutional convention reminds one of the old quip about sausages – “better eaten than seen in the making” – but the outcome was a remarkably intricate and novel legal document, whether by design, happenstance, or something in between. Some popular histories may overemphasize the wisdom of the drafters (see e.g. CAROL BERKIN, *A BRILLIANT SOLUTION: INVENTING THE AMERICAN CONSTITUTION* (2003), CATHERINE DRINKER BOWEN, *MIRACLE AT PHILADELPHIA: THE STORY OF THE CONSTITUTIONAL CONVENTION, MAY – SEPTEMBER 1787* (1986), or CHARLES L. MEE, *THE GENIUS OF THE PEOPLE* (1987)), but this should not detract from the unique character of the constitutional structure they devised.

³⁸ U.S. CONST. art. I, §§ 1-7. As Saul Levmore, *Bicameralism: When Are Two Decisions Better Than One?* 12 INT.REV.LAW & ECON. 145-62 (1992) argues, the separation of legislative powers between an upper and lower house also has important implications for the relative powers of the executive, legislative, and judicial branches. A separation of legislative powers between two houses in a bicameral legislature increases the difficulty of a legislative bargain; it thus also makes it less likely that the legislature will be able to override any veto of new legislation by the executive branch, or that it will be able to enact a statutory amendment to overrule judicial interpretations of the law that depart from legislative intent.

³⁹ U.S. CONST. art. I, § 7, cl. 2.

President.⁴⁰ At least fifty percent of the members of each of the two houses of the legislature must agree to the bargain as well as the President; if the President refuses to participate in the bargain and vetoes the new legislation then a bargain between two thirds of the members of the two houses is necessary to override the veto and enact the new legislation. This separation of powers ensures that all new legislation will have a broad base of political support.⁴¹ It also means that new legislation is difficult to enact, and that the American system of government tends to favor the status quo.

The American system of government favors the status quo not only because the U.S. Constitution requires so much legislative bargaining to enact any new proposals but also because legislative bargaining is costly.⁴² The political parties' control of the House and Senate is not strong enough to ensure that members will vote along party lines and so legislators' votes often have to be "bought" with promises of support for the legislators' own favored initiatives, important committee assignments, or a myriad of other favors,

⁴⁰ The discussion here draws on the bargaining model presented by COOTER, *supra* note 34 at 211-39.

⁴¹ Of course, the broad base of political support might derive in large measure from bargains among the legislators. Lobby groups and special interests will often succeed in having special interest legislation enacted, but usually as part of some omnibus bill. In fact, the possibility of enacting special interest legislation in such a manner increases the potential scope of legislative bargains. If a coalition of legislators is too small to force a bill through the legislature, they might be able to "buy" other legislators' support by promising to attach special interest legislation that provides specific benefits to the other legislators' constituency (e.g. funding for a new bridge or a new research institute). This kind of "pork barrel politics" is often the subject of derision, but, ironically, it can help to facilitate the enactment of other socially desirable legislation. Of course, if the entire legislative process is dominated by special interests, there is little hope that the outcomes will serve the public welfare. *Id.*

⁴² *Id.*

both small and large.⁴³ The transactions required to gain legislative support for any new proposal will usually consume a significant amount of the legislators' scarce time and energy. These transaction costs may well preclude many potentially gainful bargains and inhibit legislative enactments. In general, the higher the transaction costs of legislative bargaining, the more the legislative process favors the status quo

The separation of powers between the executive and legislative branches, and the transaction costs of legislative bargaining, have an implicit effect on the powers of the judiciary. The scope of judicial discretion is ultimately constrained in two ways: first, by the power of the executive and legislative branches to overrule controversial judicial holdings by enacting new legislation, and second, by the powers of the executive and legislative branches over judicial appointments.⁴⁴ Since the U.S. Constitution separates the power to enact new legislation so widely, the political bargains necessary to overrule the courts will be difficult to achieve. American courts thus generally have a wide range of discretion to interpret the federal laws -- a much wider range of discretion than the courts in many other countries.⁴⁵ Indeed, not all constitutions require so much bargaining to enact new legislation. In the British political system, for instance, the executive (the prime minister) is the member of the legislature (parliament) who has the support of a

⁴³ *Id.*

⁴⁴ *Id.* at 225-34.

⁴⁵ See Robert Cooter & Tom Ginsburg, *Division of Powers in the European Constitution* in THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS, (John Eatwell et al. eds. 1998) and Mark J. Ramseyer & Eric Rasmussen, *Judicial Independence in Civil Law Regimes: Econometrics from Japan*, American Law and Economics Association Annual Meeting (1996).

majority of its members.⁴⁶ There is no separation of powers between the executive and legislative branches, and thus new legislation does not require as difficult and costly a bargain as in the U.S. In general, therefore, British courts can be overruled more easily than American courts and the British political system does not confer as much discretion on the courts as the American political system.⁴⁷

The wide scope of judicial discretion in the U.S. has made the judicial appointment process (at the federal level, at least) much more political than in Great Britain and Europe.⁴⁸ Indeed, in keeping with the theory of checks and balances upon which the U.S. Constitution was based, the framers also separated the power over federal judicial appointments between the executive and legislative branches. The President was given the power to nominate federal judges and justices and the Senate was given the power of advice and consent.⁴⁹ Of course, the rules governing the tenure and terms of appointment for judges, the circumstances under which they can be impeached, and the

⁴⁶ For an overview of the British political system, see JOHN KINGDOM, *GOVERNMENT AND POLITICS IN BRITAIN: AN INTRODUCTION* (2003).

⁴⁷ COOTER, *supra* note 34 at 229. Indeed, the scope of judicial discretion in the U.S. is manifest most evidently in matters of constitutional law. The U.S. Constitution requires a much more difficult and costly bargain to amend the Constitution than to enact new federal legislation. U.S. CONST. art. 5. This fragmentation of the power to amend the Constitution has significantly enhanced the discretion of the Supreme Court in matters of constitutional interpretation. As a result, appointments to the Supreme Court have become highly politicized. See John Ferejohn, *Judicializing Politics, Politicizing Law*, 65 LAW & CONTEMP. PROB. 41 (2002) for an analysis of the relationship between political fragmentation and judicial power.

⁴⁸ Ferejohn, *supra* note 47 at 64-65.

⁴⁹ U.S. CONST. art. II, § 2, cl. 2.

assignment of the powers of reappointment are also important to the restraint of judicial discretion.⁵⁰ Although the U.S. Constitution confers lifetime tenure on justices of the Supreme Court of the United States,⁵¹ the terms of appointment for federal judges is left to the discretion of Congress (subject, of course, to the President's veto power).⁵²

As long as the judicial branch is truly independent, the judiciary will come to exercise some degree of discretion in any constitutional democracy.⁵³ If the power to enact new legislation is separated very widely and if there are no limits on the tenure and terms of appointment of judges and justices, the judiciary will tend to have a wide range of discretion.⁵⁴ It will be able to exercise this discretion to interpret the laws in ways that the executive and legislative branches did not intend and are therefore not in accord with democratic principles, narrowly conceived.⁵⁵ It will also be able to exercise its discretion to break the law free of the status quo. In this regard, the separation of powers allows the

⁵⁰ If a judge is subject to periodic reappointment, or impeachment for abuse of discretion, she may be inhibited from interpreting statutes in ways that were clearly not intended and might therefore offend the executive and legislative branches or draw public attention and criticism. If her tenure is short, she may quickly be replaced with a judge who exercises less discretion.

⁵¹ U.S. CONST. art. III, § 1.

⁵² *Id.*

⁵³ This is essentially a summary of COOTER, *supra* note 34.

⁵⁴ *Id.*

⁵⁵ One could argue, of course, that some judicial discretion is essential in any true constitutional democracy and that its exercise is not necessarily contrary to democratic principles, except perhaps in the narrowest sense.

judicial branch to serve as a source of legal innovation and experimentation, and offer an important check against legal obsolescence.⁵⁶

Guido Calabresi has used the term “legal obsolescence” to characterize the problem that arises when a statute is ill-fitted to modern circumstances and lacks legislative support.⁵⁷ He argues that obsolescent statutes often cannot be revised or repealed, presumably because of the difficulties of achieving the legislative bargain that would be necessary to enact new legislation. Most interestingly, Calabresi argues that the exercise of judicial discretion can help to alleviate the problem. From his perspective, the wide separation of legislative powers and the transaction costs of legislative bargaining not only cause legal obsolescence, they also confer discretion on the judiciary that the judiciary can – and should – use to militate against the legal obsolescence. It is difficult to dispute his claim that the wise use of judicial discretion over the interpretation of

⁵⁶ See GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 2 (1982).

⁵⁷ As Calabresi explains,

There is an alternate way of dealing with the problem of legal obsolescence: granting courts the authority to determine whether a statute is obsolete, whether in one way or another it should be consciously reviewed. At times, this doctrine would approach granting to courts the authority to treat statutes as if they were no more and no less than part of the common law. At other times, it would be used to enable courts to encourage, or even to induce, legislative reconsideration of the statute....The object in all cases would be to permit courts to keep anachronistic laws from governing us without thereby requiring them to do tasks for which they are not suited, or denying to the legislatures the decisive word in the making of constitutionally valid laws.

Id.

obsolete statutes could increase social welfare. Of course, it is easy to imagine how the ill-advised use of that discretion could be socially detrimental.

The U.S. Constitution constrains the federal government from using the terms of appointment for Supreme Court justices to limit the scope of discretion exercised by the Supreme Court,⁵⁸ and Congress has not used its control over the terms of appointment for federal judges to limit the discretion of the lower federal courts either.⁵⁹ The scope of the state courts' judicial discretion depends largely, of course, on the separation of powers in the state constitutions and the transaction costs of bargaining within the state political systems. Although most states' constitutions separate the power to enact new legislation in a manner similar to the U.S. Constitution, the states generally limit the tenure of state supreme court justices⁶⁰ as well as state judges,⁶¹ and so control over appointment and tenure is a much more important check against the exercise of judicial discretion at the state level than the federal level. Since many state judges and justices are elected, this control is often exercised by state voters.⁶²

The state constitutions and governments therefore typically exercise more restraint over state judiciaries than the federal Constitution and government exercise over

⁵⁸ U.S. CONST. art. III, § 1.

⁵⁹ Federal judges are appointed for life as long as they exhibit good behavior. See 28 U.S.C. §§ 44(b), 134(a).

⁶⁰ See TARR & PORTER, *supra* note 13 at 64, and F. Andrew Hanssen, *The Effect of Judicial Institutions on Uncertainty and the Rate of Litigation: The Election Versus Appointment of State Judges*, 28 J.LEG.STUD. 205, 213 (1999).

⁶¹ *Id.*

⁶² *Id.*

the federal judiciary. Moreover, the relatively high transaction costs of political bargaining at the federal level, on both constitutional and legislative matters, probably allows the federal judiciary to exercise more discretion on federal legal questions than the state judiciaries can exercise on state legal questions.⁶³ Of course, if state courts misapply federal law they can always be overruled by the Supreme Court, and so this also constrains the state courts' exercise of discretion on questions of federal law. But there is no similar constraint on the federal courts' exercise of their discretion over questions of state law. In practice, the federal courts' discretion over questions of state law is virtually unchecked by any system of accountability to elected officials -- state or federal. Of course, the state legislatures have the power to overrule errant federal court interpretations of state statutes, but on questions of commercial law, where the states have subordinated their usual legislative autonomy to a uniform law-making process even this check against the federal judicial power is virtually ineffective.

B. The Uniform Law-Making Process and the Inordinate

Discretion of the Federal Courts

The peculiar history of uniform law-making in the U.S. has resulted in the federal courts having more discretion over the interpretation of the commercial laws than the state courts. The U.S. Constitution confers authority over interstate commerce on the federal government,⁶⁴ but otherwise leaves matters of contract, property, torts, and crime

⁶³ Since federal legislators represent much more diverse regions and interests than state legislators, the transaction costs of bargaining among them is generally higher. See COOTER, *supra* note 34.

⁶⁴ U.S. CONST. art. I, § 8, cl. 3.

to the states.⁶⁵ Commercial law has thus traditionally been within the states' sphere of authority. This was a workable arrangement in the eighteenth and even into the nineteenth centuries, before the canals and railroads created a truly national market, but by the late nineteenth century, as the mass-production manufacturing industries emerged in the wake of the transportation revolution that allowed firms to sell their products in distant states,⁶⁶ the pressures to unify the law of commerce across the states became much more intense.⁶⁷ It was not at all clear, however, whether the interstate commerce powers of the federal government were broad enough to justify commercial codification and unification through federal legislation; most late nineteenth century business and

⁶⁵ The U.S. Constitution does not specifically grant "police powers" to the states, but the Tenth Amendment reserves powers not specially granted to the federal government for the states. Thus, police powers – those concerning health, morals, and well-being – have traditionally been construed as within the states' sphere of authority. See e.g. *Hammer v. Dagenhart* 247 U.S. 251 (1918) (holding a federal law that restricted interstate shipments of goods produced using child labor unconstitutional).

⁶⁶ For overviews of these developments see ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* (1977), DAVID C. MOWERY & NATHAN ROSENBERG, *TECHNOLOGY AND THE PURSUIT OF ECONOMIC GROWTH* (1989), and ALFRED D. CHANDLER, *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* (1990).

⁶⁷ The American Bar Association, which was instrumental in establishing the National Conference of Commissioners on Uniform State Laws, first formed a Committee on Uniform Laws in 1891. ARMSTRONG, *supra* note 32 at 20. See also Weiss, *supra* note 29 and Kevin M. Teeven, *A History of Legislative Reform of the Common Law of Contract*, 26 U.TOL.L.REV. 35 (1994).

political leaders believed they were not.⁶⁸ Regardless, there were significant political impediments to federalizing commercial law throughout the twentieth century.⁶⁹

The initial impetus to unify the commercial laws manifested itself through the newly-formed American Bar Association (ABA). In 1881 the Alabama Bar Association created a committee to make recommendations about legal unification and to advance the

⁶⁸ The Supreme Court may have expanded the scope of federal commerce powers in *Swift & Co. v. United States* 196 U.S. 375 (1905) enough to bring much commercial activity within the scope of the federal government, but many observers clearly believed that the power to regulate commerce was reserved for the states well into the twentieth century. In a New York Times article in 1910, for instance, Seth Low suggested that a constitutional amendment would be necessary to confer power over commercial law on the federal government: “Under our federal system we can obtain uniformity of statutory law in only one of two ways. We can give, by constitutional amendment, additional power to Congress: or we must develop the capacity and the habit in the separate states of acting together.” *Uniform State laws Advocated by Taft*, N.Y.TIMES. Jan. 18, 1910, at 8.

⁶⁹ The resistance to federal encroachment on areas of traditional state authority, often manifested in the rhetoric of “states’ rights,” drew much of its vigor from white racists’ attempts to suppress blacks’ civil rights well into the twentieth century. See V.O. KEY, *SOUTHERN POLITICS* (1949). As Lynn A. Baker & Ernest A. Young, *Federalism and the Double Standard of Judicial Review*, 51 DUKE L.J. 75, 143-144 (2001) observed, “the notion of states’ rights today continues to suffer mightily under the weight of [this] association.” But the assertion of states’ rights has also tended to serve other political interests. As HARMON ZIEGLER, *INTEREST GROUPS IN AMERICAN SOCIETY* 46-47 (1964) noted, business interests often find they are relatively more influential with state governments than the federal governments. Indeed, according to DONALD C. BLAISDELL, *AMERICAN DEMOCRACY UNDER PRESSURE* 48 (1957) “federalism does not involve a struggle between the nation and the states, but rather a struggle among interests who have favorable access to one of the two levels of government.”

cause in other states.⁷⁰ Then in 1889 L.D. McFarland, the president of the Tennessee Bar Association, advocated a process for achieving legal unification across the states in his annual address.⁷¹ McFarland's address led to the establishment of a committee which advanced the issue at the ABA's annual meeting in Chicago in 1889.⁷² The president of the ABA at the time was David Dudley Field, who had already drafted the "Field Code" and was a strong advocate of legal codification.⁷³ He appointed a special committee to investigate the matter further.⁷⁴ Although attendance at the special committee meetings was poor, the committee submitted a report to the ABA which recommended that the ABA request its members to prepare bills for passage in their state legislatures which would provide for the appointment of commissioners to advance the uniformity of state laws.⁷⁵

In 1890, the ABA adopted a resolution which accepted the committee's recommendations and led to the establishment of the National Conference of Commissioners on Uniform State Laws (NCCUSL).⁷⁶ The NCCUSL's mandate was to further the codification and unification of laws across the states by sponsoring the

⁷⁰ ARMSTRONG, *supra* note 33 at 17-18.

⁷¹ *Id.*

⁷² *Id.*

⁷³ Weiss, *supra* note 29.

⁷⁴ ARMSTRONG, *supra* note 33 at 18.

⁷⁵ *Id.* at 18-19.

⁷⁶ *Id.* Not all states rushed to appoint Commissioners; indeed, some states had not yet appointed any by the turn of the century. The NCCUSL nonetheless was able to proceed with its business. *Id.*

drafting of model legal codes and encouraging state legislatures to adopt them.⁷⁷ It initially sponsored a series of model commercial codes, many of which were drafted by legal academics, including the Uniform Sales Act, which was drafted by Karl Llewellyn.⁷⁸ The NCCUSL process, however, was one which left formal authority over commercial laws in the state governments, and few of the model commercial codes were widely adopted as drafted.⁷⁹ Moreover, the objectives of legal unification appeared to be frustrated from early on by divergent judicial interpretations of the uniform statutes.⁸⁰

The NCCUSL initially sought to enhance uniformity in the judicial interpretations of its bills by including within them provisions which mandated uniformity in interpretation.⁸¹ The problem persisted, however, and in 1929 the NCCUSL published a report on the various judicial decisions interpreting the Negotiable Instruments Law, which had been one of its most widely adopted uniform model codes, in which it observed that “The whole fabric, the very conception of uniformity, was being menaced

⁷⁷ The NCCUSL is funded primarily from state appropriations, but also from the ABA as well as various foundations, interest groups, and federal agencies. *Id.* at 89.

⁷⁸ N.E.H. Hull, *Restatement and Reform: A New Perspective on the Origins of the American Law Institute*, 8 LAW & HIST. REV. 55 (1990).

⁷⁹ ARMSTRONG, *supra* note 33 at 50.

⁸⁰ In his annual address as NCCUSL president in 1914 Charles T. Terry stated that “there has been as pronounced a tendency to divergence in the decisions of the courts as there has been in the enactment of statutes in the respective states. This has not been a conscious tendency, ...but it has been none the less alarming. It has been a menace to the accomplishment of our purpose, of such grave proportions, as to convince us that the attainment of our end would be jeopardized, unless some means could be found to mitigate or check the tendency.” *Id.*

⁸¹ *Id.* at 51.

by the strange attitude of the courts....[T]he courts, on identical statutes, were reaching diametrically opposite conclusions; cases from other states on the precise point were being ignored; the very statute was oftentimes neglected...”.⁸² Although this was well before the Supreme Court handed down its decision in *Erie*, it might just as easily have been stated in a much more recent report.⁸³

The early attempts at commercial codification were thus a mixed success at best.⁸⁴ Well before the middle of the twentieth century, however, a series of Supreme Court opinions had made it clear that the federal government’s commerce powers were sufficient for commercial codification to proceed through federal legislation.⁸⁵ Some influential lawyers and academics began to advocate unification of sales law through

⁸² *Id.* at 51-52.

⁸³ The Supreme Court acknowledged the challenge that divergent interpretations posed to commercial uniformity well before *Erie*: in *Commercial National Bank of New Orleans v. Canal-Louisiana Bank and Trust Company* 239 U.S. 520, 528 (1916), Justice Hughes wrote that “It is apparent that if the uniform acts are construed in the several states adopting them according to former local views upon analogous subjects, we shall miss the desired uniformity, and we shall erect upon the foundation of uniform language separate legal structures as distinct as were the former varying laws.”

⁸⁴ ARMSTRONG, *supra* note 33 at 50.

⁸⁵ The Supreme Court adopted the stream of commerce doctrine in *Swift & Co.*, 196 U.S. at 398-399. According to David Gordon, *Swift & Co. v. United States: The Beef Trust and the Stream of Commerce Doctrine*, 28 AM.J.LEGAL HIST. 244, 279 (1984), this “laid the foundation for much of twentieth century history.” It was not immediately clear that *Swift & Co.* expanded the scope of federal commerce powers enough for the federal government to enact commercial laws, but the Supreme Court subsequently upheld federal legislation in what had traditionally been state areas of authority in a number of other cases (see e.g. *Stafford v. Wallace*, 258 U.S. 495 (1922) and *NLRB v. Jones & Laughlin Steel Corp.* 301 U.S. 1 (1937)) and this eventually became clear.

federal legislation.⁸⁶ In 1922 the ABA drew on Samuel Williston's talents to draft a federal sales bill.⁸⁷ Although this was never enacted, powerful interests groups such as the Merchant's Association of New York continued to lobby for federal action.⁸⁸ Some prominent academics, such as Karl Llewellyn, also advocated unification through federal legislation.⁸⁹ William A. Schneider, the president of the NCCUSL at the time, however, was a states' rights advocate, and he urged further attempts at unification through the NCCUSL process.⁹⁰ The NCCUSL, this time in conjunction with the American Law Institute (ALI), subsequently initiated the Uniform Commercial Code project.⁹¹ The Uniform Commercial Code (UCC) was subsequently adopted by all states, and became the first (and only) true success of the NCCUSL-ALI law-making process.⁹² Proponents of states' rights, who had often resisted codification through the NCCUSL process, were finally forced to concede to commercial codification out of a fear that, if they

⁸⁶ ARMSTRONG, *supra* note 33 at 95.

⁸⁷ *Id.* at 40.

⁸⁸ *Id.* at 95.

⁸⁹ Llewellyn, who had earlier drafted the Uniform Sales Act, was by this time skeptical about the possibility of achieving uniform commercial laws through state legislation. As he wrote, "To prepare amendments to the Uniform Sales Act is possible, and is desirable. But merely to set those amendments on the road to adoption, State by State, is to throw new confusion into the field of interstate commerce. After thirty-four years, we still have one or another variety of non-uniform common law in sixteen states.... The only practicable road to real uniformity is by Congressional action." Karl N. Llewellyn, *The Needed Federal Sales Act*, 26 VA. L. REV. 558, 561 (1939-40).

⁹⁰ ARMSTRONG, *supra* note 33 at 97.

⁹¹ *Id.* For a detailed description of the NCCUSL-ALI drafting process, see Schwartz & Scott, *supra* note 4.

⁹² ARMSTRONG, *supra* note 33 at 53.

successfully resisted further attempts through the NCCUSL-ALI process working at the state level, legislation would be enacted at the federal level, and the states would suffer a further erosion of their traditional spheres of authority.⁹³

The peculiar history of legal codification in the U.S. has resulted in a peculiar institutional framework for commercial law-making. The states retain formal authority over commercial law, but de facto authority over commercial law amendments has been delegated to the NCCUSL-ALI law-making process. This has worked well enough for most parts of the UCC, but not for Article 2.⁹⁴ As the recent attempts to amend Article 2 have shown, the wide range of interests at stake and the wide bargain required for any successful amendments, preclude the process from producing truly substantive changes.⁹⁵

⁹³ In Armstrong's view, *Erie* was also a key factor because it "erased the rickety framework of Federal common law which had served as a unifying factor for commercial law since 1842, causing the Merchant's Association of New York City to press for Federal action in that field, avoidance of which ultimately resulted in the Uniform Commercial Code." *Id.*

⁹⁴ This is all in a relative manner of speaking. Financial industry interests clearly dominate the amendment processes for Articles 3, 4, and 9. See Fred H. Miller, *U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope*, 42 ALA.L.REV. 405 (1991), Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN.L.REV. 83, 121-23 (1993), and Schwartz & Scott, *supra* note 4. They also tend to be highly influential at the state legislatures. See ZIEGLER, *supra* note 69, BLAISDELL, *supra* note 69, and Ronald J. Hrebenar, *Change, Transition, and Growth in Southern Interest Group Politics*, in INTEREST GROUP POLITICS IN THE SOUTHERN STATES 352, 338-339 (Ronald J. Hrebenar et al. eds., 1992). This facilitates revisions to Articles 3, 4, and 9 but possibly at the expense of consumer and other non-financial interests.

⁹⁵ As Schwartz & Scott, *supra* note 4 at 597, 645-648 observe, the recent amendments to Article 2 were produced by a study group that was dominated by reformers. It thus tended to propose vague standards instead of bright line rules. Schwartz and Scott correctly predicted that the process would fail.

The only amendments that can survive the bargaining process are the ones that are non-controversial and there is thus little incentive for state legislatures to enact them.⁹⁶ Indeed, even if the NCCUSL-ALI process did produce meaningful amendments to Article 2, lobbying by interested business and consumer groups at the state level would probably impede many state legislatures from adopting them, and the uniformity of the code would be compromised anyway.⁹⁷ The de facto power over the enactment of new sales legislation has been far too widely separated to permit an easy revision process.

The diffuse power over the enactment of new sales legislation confers a wide range of discretion over the interpretation of Article 2 on both the federal and state courts.⁹⁸ In practice, however, the range of discretion conferred upon the federal courts is much wider than that conferred upon the state courts. Federal judges and justices are appointed by federal officials. Barring any cause for impeachment, federal judges and justices may serve indefinitely.⁹⁹ Neither are subject to periodic review and reappointment. Even if they were, they would be subject to reappointment by federal officials rather than state officials. State judges and justices are often elected,¹⁰⁰ and even

⁹⁶ *Id.*

⁹⁷ The states have certainly not rushed to adopt the recent amendments to Article 2, even though they are hardly as significant as many had hoped.

⁹⁸ As Schwartz & Scott, *supra* note 4 at 606 observe, the process does not empower the NCCUSL and ALI to overrule courts that interpret UCC provisions in ways the drafters did not intend. The courts can only be overruled by higher courts within their own jurisdiction.

⁹⁹ J. Mark Ramseyer, *The Puzzling Independence of Courts: A Comparative Approach*, 23 J. LEG. STUD. 721, 728 (1994) describes the prevailing federal rule as “hands-off-the-courts.”

¹⁰⁰ SUSAN P. FINO, *THE ROLE OF STATE SUPREME COURTS IN THE NEW JUDICIAL FEDERALISM* 20, 34 (1987).

if they are appointed by elected officials, they are usually only appointed for limited terms.¹⁰¹ They are therefore usually subject to replacement, reappointment, or reelection on a periodic basis. Most importantly of all, they are subject to reappointment or reelection by state officials or state voters, not by federal officials. In short, federal judges and justices are completely beyond the control of the individual states' electorates; state judges and justices are not.

Since federal court rulings on questions of state law cannot be appealed to state courts, and since neither elected state officials nor the states' electorates have any control over the appointment or reappointment of federal judges and justices, the federal courts actually have a wider range of discretion over the interpretation of state law than the state courts. This is a phenomenon associated with the exercise of the federal courts' diversity jurisdiction generally.¹⁰² In the field of commercial law, however, and especially the sub-field of sales law, the problem is much more acute. The impossibility of a state court overruling a federal court's interpretation of a state statute, and the difficulty of overruling federal interpretations of sales statutes through the NCCUSL-ALI process, together with the absence of any check on federal judicial discretion through periodic reappointment and/or renewal of federal judges, means that the federal courts have

¹⁰¹ *Id.* at 59.

¹⁰² TARR & PORTER, *supra* note 13 at 19-22. As Tarr and Porter note, the federal courts remain important to the development of state common law generally: "because federal courts confront common law issues, they contribute to the development of the common law, and state courts may draw upon their rulings in enunciating common law principles." *Id.*

almost unbridled discretion in their rulings on any questions arising under Article 2.¹⁰³ Whether their autonomy is unwholesome is a matter open to debate. On the one hand, it creates the potential for an exercise of judicial discretion that is inconsistent with modern notions of democracy and judicial restraint, but, on the other hand, it allows the federal courts to militate against the legislative obsolescence that otherwise tends to result from the strong bias in favor of the status quo that is inherent in the NCCUSL-ALI process.

There is, in fact, a trade-off implicit in the role the federal courts currently play in the development of commercial law. The wide discretion the federal courts enjoy in interpreting state commercial law statutes and their immunity from any oversight or control by the state electorate or elected state officials clearly raise questions about the role of the federal judiciary, yet, given the difficulty of revising Article 2 through the NCCUSL-ALI process and the inertia that would otherwise leave modern sales law in the grip of the status quo,¹⁰⁴ the federal judiciary is also the most important source of innovation and experimentation in modern sales law. It is clear that the most controversial interpretations of Article 2 within the last several years have been rendered by federal courts.¹⁰⁵ In some cases federal courts appear to have consciously used their discretion in attempts to fashion new rules in accord with evolving commercial practices and standards rather than simply interpret the statutes as drafted.¹⁰⁶ Ironically, they

¹⁰³ Of course, state courts are not bound by federal court rulings on questions of state law, and, in theory, a state court could have an opportunity to correct an errant federal ruling in a subsequent case. But in practice, this is unlikely. See the discussion *supra* note 20.

¹⁰⁴ Schwartz & Scott, *supra* note 4 at 597.

¹⁰⁵ See the discussion *infra* part III.

¹⁰⁶ See the discussion *infra* part III.

appear to be acting out of similar motivations to those federal courts in the nineteenth century that, under the authority of *Swift v. Tyson*, disregarded state commercial law holdings and instead appealed to the broader principles and imperatives of commerce in attempts to fashion uniform rules of commercial law.¹⁰⁷

The peculiarities of the commercial law-making process in the United States in conjunction with the unique American system of judicial federalism thus place the federal courts in a unique and important position. In some ways the role they play is similar to the role of traditional common law courts. While many might contend that this is undemocratic, some scholars have argued that the common law process is not only more innovative but ultimately more efficient than the statutory law-making process that has largely replaced it.¹⁰⁸ Whether the federal courts' exercise of their discretion is for good or ill will ultimately depend on the consequences. As the following discussion suggests, however, at this point it has only exacerbated the tendency toward contention and disunity in modern American sales law. Moreover, in some cases the courts' exercise of their discretion has been so bold that it challenges conventional notions about the role of the judiciary and the scope of federal judicial powers.

¹⁰⁷ See the discussion *supra* note 28.

¹⁰⁸ See, for instance, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 397-427(1977), George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J.LEGAL STUD. 65 (1977), Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J.LEGAL STUD. 51 (1977), and Paul G. Mahoney, *The Common Law and Economic Growth: Hayek Might be Right*, 30 J.LEGAL STUD. 503 (2001).

III. THE FEDERAL COURTS AND MODERN SALES LAW CONTROVERSIES

A. *Computer Software and the Scope of the UCC*

One of the stumbling blocks in recent efforts to amend Article 2 has concerned its scope, specifically whether it should extend to transactions in computer software and other forms of computer information.¹⁰⁹ The matter was the primary subject of a controversial ruling in 1991 by Judge Weis of the Third Circuit in *Advent Systems Limited v. Unisys Corp.*¹¹⁰ *Advent Systems* involved two corporate parties, the named principals in the case. Unisys contracted with Advent to provide the software and related hardware for the document systems that Unisys was planning to sell with its computers in the US market.¹¹¹ Under the terms of the contract Advent was also obligated to provide sales and marketing materials and assistance with the construction and installation of the document systems.¹¹² The contract period was for two years with a provision for automatic renewal or termination by notice.¹¹³ Unisys, however, was restructuring and, perhaps as a consequence, decided that it wanted to develop its own document system. It

¹⁰⁹ In the end, the drafters punted: the proposed revisions to Article 2 leave the scope of Article 2 to the case law. As the preliminary official comment to 2-103(k) states, “When a transaction involves both the sale of goods and the transfer of rights in information, it is up to the courts to determine whether the transaction is entirely within or outside of this article, or whether or to what extent this article should be applied to a portion of the transaction.” Proposed Revised U.C.C. § 2-103(k) cmt (2003).

¹¹⁰ *Advent Systems Limited v. Unisys Corp.*, 925 F.2d 670 (3rd Cir. 1991).

¹¹¹ *Id.* at 672.

¹¹² *Id.*

¹¹³ *Id.*

informed Advent that “their arrangement had ended.”¹¹⁴ Advent sued alleging breach of contract.

At trial, the court applied Pennsylvania law, with the agreement of both parties.¹¹⁵ The trial judge decided that Pennsylvania common law should apply to the contract rather than Article 2, and the jury found Unisys liable for damages of over \$4m for breach of contract.¹¹⁶ Unisys appealed, arguing that the trial judge erred in applying Pennsylvania common law rather than Article 2, that the contract was not enforceable against Unisys under the statute of frauds provision in UCC § 2-201 because the writing lacked a quantity term, and that, even if it was enforceable, the contract lacked sufficient definiteness upon which to base a remedy.¹¹⁷ Under Pennsylvania common law, the statute of frauds did not bar Advent from enforcing the contract, nor did Advent’s claim fail for lack of a reasonably certain basis for providing a remedy. The case thus turned on the trial judge’s decision to apply the common law.

Judge Weis began by invoking the predominant factor test, although he did not explicitly refer to it as such.¹¹⁸ He looked first to the language of the writing, and noted that it began with a statement that described Unisys’s objective under the agreement as being to “purchase” and Advent’s as being to “sell” certain of Advent’s hardware

¹¹⁴ These are the words Judge Weis used to describe what was communicated. *Id.*

¹¹⁵ The contract included a provision specifying that Pennsylvania law would apply. That may have obviated the need for a difficult determination as to the choice of law. Advent Systems is a British company and it was contracting with a British subsidiary of Unisys, an American company. *Id.* at 673.

¹¹⁶ *Id.* at 672.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 674.

“products” and software licenses for “resale”.¹¹⁹ He noted that a subsequent heading described the subject matter of the transaction as a “sale” and that the section there-under also used the words “buy” and “sell” and “products” -- words which are all generally indicative of a contract for the sale of goods rather than a contract for services.¹²⁰ He noted that Advent was supposed to invoice Unisys for each product purchased and for maintenance fees separately.¹²¹ The charge for Advent’s support services was to be 3% per annum of the list price of each software module sold by Unisys.¹²² Some additional services were to be provided at no cost.¹²³ The relatively small share of the charges for services was also indicative of a sales contract.

This would have been enough for the court to rule that the contract was one for the sale of goods rather than the supply of services, but Judge Weis proceeded to render a holding about the nature of software generally. He characterized software as “the medium that stores input and output data as well as computer programs” where the medium is in the form of a hard disk, floppy disk, or magnetic tape.¹²⁴ Judge Weis noted the voluminous academic commentaries on the nature of software and observed that most of it favored the view that software was a good within the meaning of the UCC § 2-

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

102.¹²⁵ Moreover, he noted that defining software as a good would bring transactions in software within the scope of Article 2 generally and that this would serve to unify the body of law applied to disputes arising from computer software transactions.¹²⁶ In his view, this was a strong policy argument for including transactions in computer software within the scope of Article 2. He therefore went beyond simply ruling that the contract in dispute was one for the sale of goods and held that “software is a good within the definition in the Code.”¹²⁷

It is far from obvious that Judge Weis was pleased with the implications of this holding for the case at hand. The statute of frauds provision for Article 2 in UCC § 2-201(1) clearly states that “A writing ... is not enforceable under this paragraph beyond

¹²⁵ *Id.* at 675-676. The Code is not particularly helpful. U.C.C § 2-102 (2005) states that “this article applies to transactions in goods”, and U.C.C § 2-105(1) 2005 defines goods as “all things ...which are movable at the time of identification to the contract for sale.” Computer software itself is intangible, but it is usually encoded on some movable thing, such as a floppy disc or a computer hard drive. Judge Weis may have been correct about the weight of the academic commentary at the time he wrote his opinion, but the weight has probably shifted seen then. See the discussion *infra* notes 146 and 147.

¹²⁶ *Id.* at 676.

¹²⁷ *Id.* It is not clear how broadly Judge Weis meant for this holding to apply. He had earlier noted that “Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners.” *Id.* at 675. As he elaborated, “That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available at the marketplace.” *Id.* It is plausible to interpret Judge Weis’ holding, therefore, to mean that computer software is a good when it is encoded on some kind of computer disc or hardware. Indeed, some federal district courts in Pennsylvania have adopted this interpretation. See the discussion *infra* note 150.

the quantity of goods shown in such writing.”¹²⁸ This was an impediment to Advent in seeking enforcement of the contract because the writing executed between Advent and Unisys had no quantity term. Of course, as Judge Weis noted, UCC § 2-201(1) states only that a contract under Article 2 is not enforceable beyond the quantity shown, not that a quantity must be shown for a contract to be enforceable.¹²⁹ Although the plausibility of this interpretation has been acknowledged by some commentators,¹³⁰ it has not been widely followed.¹³¹ Judge Weis therefore eschewed that approach in favor of another that drew an analogy between the contract between Advent and Unisys and an exclusive requirements contract. Judge Weis reasoned that, although the contract between Advent and Unisys was nonexclusive, it was similar to an exclusive requirements contract in many ways.¹³² Since Article 2 does not require an output term in exclusive requirements contracts,¹³³ Judge Weis held that an output term was not strictly required for Advent to enforce its contract with Unisys.¹³⁴

Judge Weis’ reasoning on this point was tenuous at best. Although UCC § 2-306 does not strictly require an output term in an exclusive requirements contract, that is

¹²⁸ U.C.C. § 2-201(1) (2005).

¹²⁹ *Advent Systems*, 925 F.2d at 677.

¹³⁰ See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 2-4, 81-82 (1988) and J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 19-34, 827 (1987).

¹³¹ According to Judge Weis, “Courts have generally found that a quantity term must be stated...”. *Advent Systems*, 925 F.2d at 677.

¹³² *Id.* at 678.

¹³³ See U.C.C. § 2-306(1) (2005).

¹³⁴ *Advent Systems*, 925 F.2d 670 at 679.

clearly because the buyer's requirements can be used as a good faith proxy. Indeed, UCC § 2-306(1) states that "A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith...".¹³⁵ The UCC thus makes it clear that the good faith requirements of the buyer in an exclusive requirements contract are to be treated as equivalent to a specific output term. Since the contract is for the buyer's exclusive requirements, there are no other suppliers to which the buyer can turn, and the buyer's good faith requirements are a reasonable proxy for a specific output term. The contract between Advent and Unisys, however, was not an exclusive requirements one.¹³⁶ Hence, Unisys' good faith requirements could not have been a reliable proxy for the contract's output term since Unisys was apparently free to satisfy its requirements from other suppliers. Judge Weis' analogy between the contract in *Advent Systems* and an exclusive requirements contract stretches the scope of UCC § 2-306 well beyond anything the drafters could have intended.

It also does an end run around the statute of frauds requirements in UCC § 2-201.¹³⁷ There is clearly some ambiguity about the wording of UCC § 2-201(1). Nonetheless, the comments to UCC § 2-201 seem to make it clear that UCC § 2-201(1) was meant to imply that a quantity term is required for a contract to be enforceable. As official comment 1 notes, "The only term which must appear is the quantity term which

¹³⁵ U.C.C. § 2-306(1) (2005).

¹³⁶ As Judge Weis noted, "the parties arrived at a non-exclusive requirements contract, a commercially useful device." *Advent Systems*, 925 F.2d 670 at 678.

¹³⁷ U.C.C. § 2-201(1) (2005).

need not be accurately stated but recovery is limited to the amount stated.”¹³⁸ And later, “Only three definite and invariable requirements as to the memorandum are made by this section.... third, it must specify a quantity.”¹³⁹ The buyer’s good faith requirements in an exclusive requirements contract are, by the express provisions of UCC § 2-306(1), sufficient to satisfy the output requirement in UCC § 2-201(1). But there is no statutory basis for holding that the buyer’s good faith output in a nonexclusive requirements contract is sufficient to satisfy the output requirement. Judge Weis’ opinion is not consistent with a plain reading of the Code.

Advent Systems faced yet another hurdle in its attempt to recover from Unisys in UCC § 2-204(3).¹⁴⁰ UCC § 2-204(3) states that a contract does not fail for indefiniteness even though one or more terms are left open if “the parties have intended to make a contract and there is a reasonable certain basis for giving an appropriate remedy.”¹⁴¹ This suggests, of course, that a contract does fail if there is not a reasonably certain basis for giving an appropriate remedy. With no output term in the contract, Advent could not easily prove its damages. Judge Weis did not attempt to resolve the matter; instead, he remanded the case to the lower court for a determination as to whether the contract provided a reasonably certain basis for calculating Advent’s damages.¹⁴² He did, however, frame the inquiry for the trial court by suggesting that a sound basis for calculating damages might be found by estimating what Unisys’s good faith output

¹³⁸ U.C.C. § 2-201(1) cmt 1 (2005).

¹³⁹ U.C.C. § 2-201(1) cmt 1 (2005).

¹⁴⁰ U.C.C. § 2-204(3) (2005).

¹⁴¹ U.C.C. § 2-204(3) (2005).

¹⁴² *Advent Systems*, 925 F.2d 670 at 680.

requirements would have been.¹⁴³ Here again Judge Weis drew on an analogy to an exclusive requirements contract. As official comment 2 to UCC § 2-306 states, “Under this section, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party.”¹⁴⁴

The problem with this analogy, once again, is that the contract between Advent and Unisys was not an exclusive requirements one. Hence, Unisys’s good faith output requirements could not serve as a reliable proxy for an output term and they did not provide a reasonably certain basis for calculating Advent’s damages. One cannot help but suspect that Judge Weis points the district court in this direction to avoid the potentially harsh consequences for Advent of his holding that the contract was for the sale of goods rather than services.

Advent was awarded damages at trial in a contest that was adjudicated under Pennsylvania common law. Judge Weis overturned the trial court and held that Article 2 applied to the case and indeed would apply to any case in which computer software was the predominant factor in the contract. Yet Judge Weis’ sympathies clearly lay with Advent. Unisys reneged on the deal and Advent was left in the lurch. There is little doubt that Advent lost the benefit of a bargain. But by holding that Article 2 applied to the case rather than the common law, Judge Weis exposed Advent to a potential bar to its enforcement of the contract from the statute of frauds. Judge Weis’ creative interpretation of UCC § 2-201(1) prevented Advent from facing a strict bar to enforcement, but Advent was still exposed to the risk that its suit would fail for lack of a

¹⁴³ *Id.*

¹⁴⁴ U.C.C. § 2-306(1) cmt 2 (2005).

reasonably certain basis for providing a remedy. Judge Weis thus went to the trouble of suggesting to the trial court (and Advent) how the contract might be construed to provide a reasonably certain basis for calculating a remedy, again drawing on the dubious analogy with an exclusive requirements contract. By all appearances, Judge Weis went to great lengths to help Advent out of the bind in which he put them by deciding the case under Article 2 instead of the common law.

As Judge Weis made clear, his decision to apply Article 2 was driven by utilitarian calculations.¹⁴⁵ Indeed, his calculations had less to do with the case at hand than with the scope of Article 2 generally. He could easily have decided that, under the predominant factor test, the contract between Advent and Unysis was primarily for services rather than goods and simply upheld the district court. And he could have held that the contract was primarily for goods and applied Article 2 without rendering an opinion about the nature of computer software in general. But it would have been difficult for Judge Weis to hold that computer software is a good and that the contract between Advent and Unisys was primarily one for services. Since Weis clearly wanted to extend the scope of Article 2 to computer software, he was forced to apply Article 2 to the contract as a consequence. But since his sympathies in the case appeared to lie with Advent, he also fashioned an unusual justification for excluding the effect of the statute

¹⁴⁵ As he wrote, “Applying the U.C.C. to computer software transactions offers substantial benefits to litigants and the courts. The Code offers a uniform body of law on a wide range of questions likely to arise in computer software disputes: implied warranties, consequential damages, disclaimers of liability, the statute of limitations, to name a few....The importance of software to the commercial world and the advantages to be gained by the uniformity inherent in the U.C.C. are strong policy arguments favoring inclusion.” *Advent Systems*, 925 F.2d 670 at 676.

of frauds and even suggested how the district court might construe a reasonable basis for calculating Advent's damages in the absence of any reliable proxy for an output term.

It is debatable whether Judge Weis' efforts to bring transactions in computer software within the scope of Article 2 were to good effect. In spite of Judge Weis' utilitarian calculations, some commentators believe Article 2 is ill-suited to transactions in computer information.¹⁴⁶ For one thing, transactions in computer information usually only involve the transfer of a license, not a fee simple absolute. This makes the warranty provisions of Article 2 somewhat inappropriate.¹⁴⁷ Indeed, the NCCUSL and ALI approved the Uniform Computer Information Transactions Act (UCITA) in 1999 specifically for transactions involving the transfer of rights in computer information.¹⁴⁸ Although UCITA has not been widely adopted,¹⁴⁹ it only exists because there was a widespread view that neither the common law nor Article 2 provides adequate governance mechanisms for computer information transactions. At this point, Judge Weis' holding in *Advent Systems* has not been widely followed,¹⁵⁰ but if it is, it may simply force computer information transactions into a legal box they do not fit.

¹⁴⁶ See generally Lorin Brennan, *Why Article 2 Cannot Apply to Software*, 38 DUQUESNE L. REV. 459, 517 (1999).

¹⁴⁷ Id. See also CLAYTON P. GILLETTE & STEVEN D. WALT, *SALES LAW: DOMESTIC AND INTERNATIONAL* 23 (1999).

¹⁴⁸ Brennan, *supra* note 146 at 461.

¹⁴⁹ According to the NCCUSL website, as of writing UCITA has been adopted only by Maryland and Virginia. See http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ucita.asp.

¹⁵⁰ It has been followed most notably by the Seventh Circuit in *Micro Data Base Systems, Inc. v. Dharma Systems, Inc.* 148 F.3d 649 (7th Cir. 1998); it was cited favorably, but not strictly followed in *Smart Online Inc. v. Opensite Technologies, Inc.* 2003 NCBC 5 (NC Sup. Ct. 2003); it has been distinguished, however,

B. Hill v. Gateway and the Rolling Contracts Controversy

Few commercial law cases have raised as much controversy as Judge Easterbrook's opinion in *Hill v. Gateway*.¹⁵¹ The case involved two consumers, Rich and Enza Hill, who ordered a personal computer from Gateway over the telephone.¹⁵² At the time of the telephone order, the Hills were apparently not given notice of any special contract terms or otherwise informed that the manner of contracting would differ from the norm in any way.¹⁵³ The Hill's computer arrived in a box, however, and the box included a writing which purported to list additional contract terms.¹⁵⁴ One of the terms was an arbitration clause, which obliged the Hills to submit any disputes to arbitration if they retained possession of the computer for more than thirty days.¹⁵⁵ The Hills did retain the computer for more than thirty days before complaining about some of its components and its performance.¹⁵⁶ Gateway was unable or unwilling to address their complaints to their satisfaction and so they filed suit in a federal district court asserting claims under Illinois sales law.

in a number of cases, including some heard in federal district courts in the Third Circuit – see, e.g., *Honeywell, Inc. v. Minolta Camera Co.*, 1991 U.S. Dist. Lexis 20743 (D.N.J. 1991) and *Triple Point Technology, Inc. v. D.N.L. Risk Management, Inc.*, 2000 U.S. Dist. Lexis 22327 (D.N.J. 2000).

¹⁵¹ *Hill v. Gateway 2000, Inc.* 105 F.3d 1147 (7th Cir. 1997).

¹⁵² *Id.* at 1148.

¹⁵³ This can be presumed from Judge Easterbrook's description of the case. *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

At trial, Gateway asked the district judge to enforce the arbitration clause and dismiss the suit.¹⁵⁷ The judge refused, and Gateway initiated an interlocutory appeal under 9 U.S.C. Section 16(a)(1)(A).¹⁵⁸ The case thus came before Judge Easterbrook on the question of the validity of the arbitration clause. Easterbrook vacated the district court's decision and remanded the case with instructions to compel the Hill's to submit their case to arbitration.¹⁵⁹ His disposition of the question has not only provided an important precedent for other courts to consider, it has also initiated an ongoing debate about merits of a new theory of contract formation -- the theory of "rolling contracts."¹⁶⁰ Judge Easterbrook's opinion has been widely criticized and for a variety of reasons. But many of the criticisms have been so obvious that Judge Easterbrook must have anticipated them. Because of that, and because of the great esteem in which Judge Easterbrook is held, *Hill v. Gateway* deserves a careful analysis, and Judge Easterbrook's reasoning should be accorded considerable respect.

Judge Easterbrook essentially follows *ProCD, Inc. v. Zeidenberg*.¹⁶¹ In *ProCD* the Seventh Circuit held that under Illinois law a customer who bought software that was

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 1151.

¹⁶⁰ This has spawned a profusion of academic commentary. See, e.g., Roger C. Bern, "Terms Late" *Contracting: Bad Economics, Bad Morals, and a Bad Idea for a Uniform Law*, Judge Easterbrook *Notwithstanding*, 12 J.L.&POL'Y 641 (2004), Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, 2004 WISC.L.REV. 679 (2004), and William H. Lawrence, *Rolling Contracts Rolling Over Contract Law*, 41 SAN DIEGO L.REV. 1099 (2004).

¹⁶¹ *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

on a CD contained in a box was bound by contract terms inside the box after the customer had an opportunity to read the terms and reject them by returning the software.¹⁶² The Hills attempted to distinguish their case from *ProCD* to no avail. They first argued that *ProCD* should be limited to software.¹⁶³ Judge Easterbrook was not convinced. As he put it, “*ProCD* is about the law of contract, not the law of software.”¹⁶⁴ Next they argued that *ProCD* was an executory contract and its precedential effect should be limited to executory contracts.¹⁶⁵ Judge Easterbrook correctly observed, however, that the contract in *ProCD* was no more executory than the contract between the Hills and Gateway.¹⁶⁶ In fact, sales contracts are usually executory for at least some time, since there are usually warranties that extend for a considerable duration.

At oral argument, the Hills noted that in *ProCD* the software packaging included writing on the exterior that provided notice of additional terms inside.¹⁶⁷ Thus, since the software was sold through retail stores, any customer who purchased it should have had notice of the additional terms before making the purchase. The box containing Gateway’s computer did not provide such notice.¹⁶⁸ Judge Easterbrook attributed the difference to the differences in the functionality of the boxes in the two cases: one was

¹⁶² *Id.* at 1452.

¹⁶³ *Hill v. Gateway*, 105 F.3d at 1149.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 1150.

¹⁶⁸ *Id.*

for display, whereas the other was only for delivery.¹⁶⁹ He thus implied that the writing on the box was irrelevant. Finally, the Hills argued that they were consumers, whereas the customer in *ProCD*, Zeidenberg, was a merchant.¹⁷⁰ Thus, the additional terms inside the software packaging became part of Zeidenberg's contract with ProCD under UCC § 2-207(2), but in their case the additional terms inside the box containing the computer did not become part of their contract with Gateway. Judge Easterbrook dismissed the argument as inapt: the question was not whether additional terms should be added to the contract, but when the contract was formed.¹⁷¹

Judge Easterbrook thus construed the case as one about the time of the formation of the contract. Since the Seventh Circuit had already addressed a similar question in *ProCD*, and since Judge Easterbrook viewed *ProCD* as a controlling case, there was little need for further consideration of the Hill's claim.¹⁷² Nonetheless, Judge Easterbrook elaborated on the policy rationale for his holding in his dicta.¹⁷³ In his view, the Hills must have known that important contract terms would be included in the packaging when

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² Reliance on *ProCD* was highly controversial for a number of reasons. *ProCD* was not a simple sales case, since it involved computer software. As the preceding discussion of *Advent Systems* suggests, the appropriate choice of law for contractual disputes involving computer software remains highly contentious. Moreover, since many commentators believe *ProCD* applied Article 2 incorrectly, it is hardly persuasive under the similar facts of *Hill v. Gateway*. Finally, the dispute in *ProCD* did not arise from a telephone order, and so U.C.C. § 2-206(1)(b) did not apply.

¹⁷³ *Hill v. Gateway*, 105 F.3d at 1150.

they ordered their computer.¹⁷⁴ He noted that Gateway's ads stated that their computers came with a limited warranty and lifetime support.¹⁷⁵ Presumably, the Hills must have known that the precise terms of the warranty would be provided inside the packaging of their computer upon the computer's delivery. By implication, therefore, they should have known that other important contract terms might also be included inside the packaging.

Easterbrook noted that the law provides consumers with three principal ways of finding out about the specific terms of their contracts.¹⁷⁶ First of all, they can ask the vendor to provide the specific terms before making their purchase.¹⁷⁷ Thus, the Hills could have requested the information before making their telephone order. Second, they can avail themselves of the vast amount of information available from public sources, such as vendors' websites, consumer publications, etc.¹⁷⁸ The Hills presumably could have found out about the arbitration clause merely by doing a little research beforehand. Finally, consumers can simply read the information that vendors include inside the packaging of their products, including any information about the precise contract terms. The Hills clearly had an opportunity to do so; Judge Easterbrook suggests that, by keeping the computer for more than thirty days, they thus impliedly accepted the contract arbitration clause.¹⁷⁹

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

Easterbrook implies that any inconvenience to consumers caused by the burden of having to research the terms of their contracts are outweighed by the practical advantages of allowing vendors to include contract terms in the packaging of their products.¹⁸⁰ Indeed, in his view, it would be highly impractical to expect all vendors to provide complete information about all contract terms prior to their customers' purchases. As he explained,¹⁸¹

Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct-sales operations such as Gateway's had to read the four-page statement of terms before taking the buyer's credit card number, the droning voice would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers' assertions...that the clerk did not read term X to them....

As one would expect, Easterbrook's reasoning is compelling. Some have doubted, however, whether the practical difficulties of providing customers with information prior to their purchases are as great as Easterbrook claims.¹⁸² According to Honnold and Reitz,¹⁸³ for instance, there is no practical difficulty for sellers in "disclosing, or at least outlining, rights-negating terms at the point of sale... whether by

¹⁸⁰ *Id.* at 1149

¹⁸¹ *Id.*

¹⁸² See, e.g., Bern *supra* note 160.

¹⁸³ JOHN O. HONNOLD & CURTIS R. REITZ, SALES TRANSACTIONS: DOMESTIC AND INTERNATIONAL LAW 248 (2006).

telephone, email, or in-store.” But Judge Easterbrook seems to have a point. First of all, it is not at all clear whether a seller would provide sufficient information to satisfy the formalities of contract by merely outlining right-negating terms. Second, it is not even clear whether basic information about complex contract terms can be adequately communicated via telephone. Customers simply may not be able to comprehend significant amounts of information about complex contract terms communicated over the telephone. Indeed, attempts to contract around the usual contract rules in such a manner might well be considered unconscionable. And finally, telephone orders in particular raise difficult evidentiary problems. It is not clear how the seller could prove that every customer always received all the information. Even if all telephone orders were recorded it would still be difficult to prove that the customer correctly heard every contract term. Moreover, compelling sellers to record every telephone order and establish a suitable system for storing and retrieving the recordings would put them to considerable expense.

Nonetheless, on its face, *Hill v. Gateway* appears to misapply the UCC. This is ironic, because Article 2 is quite liberal in general about the formation of contracts. UCC § 2-204(1) states that a contract may be made in “any manner sufficient to show agreement.”¹⁸⁴ The official comment explains that this continues the policy of recognizing any manner of expression -- oral, written, or other -- as sufficient to form a contract, subject, of course, to other rules governing the legal effect of such expressions, such as the parole evidence rule.¹⁸⁵ Even the parties’ conduct can be sufficient to form a

¹⁸⁴ U.C.C. § 2-204(1) (2005).

¹⁸⁵ U.C.C. § 2-204 cmt (2005).

contract if it is construed as recognizing the existence of an agreement.¹⁸⁶ Indeed, UCC § 2-204(2) states that a contract may be formed even though the “moment of its making is undetermined.”¹⁸⁷ As the official comment explains, this recognizes that the interactions of the parties might be sufficient to form a contract without clearly indicating the precise point at which the formation occurred.¹⁸⁸ UCC § 2-206(1)(a) complements UCC § 2-204 by obliging courts to construe offers as inviting acceptance “in any manner and by any medium reasonable in the circumstances” unless otherwise “unambiguously indicated.”¹⁸⁹ As the official comments elaborate, “this section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.”¹⁹⁰

UCC §§ 2-204(1), 2-204(2) and 2-206(1)(a) by themselves thus appear to provide a statutory basis for Easterbrook’s *Hill v. Gateway* holding. Under UCC § 2-204(1) a court could construe Gateway’s delivery of the computer, complete with the terms on the writings inside the packaging, as an offer. Under UCC § 2-206(1)(a) Gateway’s thirty day window for rejecting the terms by returning the computer could be construed as inviting acceptance through the Hills’ conduct -- the failure to return the computer within the time specified in Gateway’s offer. This would be consonant with the policy stated in the official comment to UCC § 2-206 of extending the UCC’s flexible formation rules to a present day medium -- the telephone -- as it comes into more general commercial use.

¹⁸⁶ *Id.*

¹⁸⁷ U.C.C. § 2-204(2) (2005).

¹⁸⁸ U.C.C. § 2-204 cmt (2005).

¹⁸⁹ U.C.C. § 2-206(1)(a) (2005).

¹⁹⁰ U.C.C. 2-206 cmt 1 (2005).

Indeed, even if Gateway had not provided a thirty day window for returning the computer, under UCC §§ 2-204(2) and 2-206(1)(a) a court might have construed the Hill's decision not to return the computer within a reasonable time as acceptance, even though the precise time of formation might have been indeterminable.

But UCC §§ 2-204(1), 2-204(2), and 2-206(1)(a) do not stand by themselves. Although Article 2 is in general quite liberal about the formation of contracts, it provides a specific rule in cases where a party makes a telephone order -- or, indeed, makes an order to buy goods of any kind. UCC § 2-206(1)(b) states that, "unless otherwise unambiguously indicated,... an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods....".¹⁹¹ On its face, this appears to oblige courts to construe a telephone order, such as the one made by the Hills, as an offer to buy goods. The offer should presumably be construed as one to buy goods subject to the usual rules of commercial contracting under Article 2, unless it is made in such a way as to clearly modify them. Thus, one should presume that the buyer intends to retain all of her rights under the warranty of title in UCC §2-312 and the warranties of quality in UCC §§ 2-313, 2-314, and 2-315, as well as all of her rights to remedies for breaches of those warranties elsewhere in Article 2, unless she indicates otherwise in making her order. The seller's prompt or current shipment of the goods must be construed as an acceptance of the buyer's offer, and unless the seller unambiguously indicates otherwise, the buyer is entitled to all of the usual warranties and remedies available under Article 2.

¹⁹¹ U.C.C. § 2-206(1)(b) (2005).

A seller is nonetheless not compelled to accept all of the usual rules governing the buyer's rights and remedies. As UCC § 2-206(1)(b) explains, "shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer."¹⁹² It is not entirely clear what this means, but the wording suggests that the seller can contract around the buyer's usual rights and remedies. UCC § 2-106(2) defines conforming goods as goods "in accordance with the obligations under the contract."¹⁹³ Nonconforming goods are thus presumably goods that are not in accordance with the seller's obligations under the contract. But 2-206(1)(b) states that if the seller seasonably notifies the buyer that the shipment is only an accommodation to the buyer, the seller's shipment of nonconforming goods does not constitute an acceptance. If it does not constitute an acceptance then there is no contract to which the goods can conform and this part of UCC § 2-206 does not make much sense. The reference to "the shipment of nonconforming goods" in UCC § 2-206(1)(b) is thus best understood as meaning a shipment that is not in accordance with the seller's obligations under the terms of the buyer's offer. In a typical telephone order, the terms of the buyer's offer would normally include all of the default rules of Article 2. If the seller notified the buyer that the shipment was only an accommodation, however, and not an acceptance, the formation of the contract would be delayed. The seller could include writings with the shipment of goods that defined the terms of an offer; the buyer's conduct (such as retaining possession of the goods for more than thirty days) could then constitute an acceptance of the offer.

¹⁹² U.C.C. § 2-206(1)(b) (2005).

¹⁹³ U.C.C. § 2-106(2) (2005).

Indeed, even if the seller did not explicitly contract around the usual default rules of Article 2 in this manner, there is a qualification placed on both parts (a) and (b) of UCC §§ 2-206(1) by the words, “Unless otherwise unambiguously indicated by the language or circumstances.”¹⁹⁴ These qualifying words provide the strongest rationale available under Article 2 for Judge Easterbrook’s *Hill v. Gateway* holding, although ironically it is not a rationale that Easterbrook himself explicitly stated. They imply that if the circumstances of a telephone order unambiguously indicate that the seller’s shipment of goods does not operate as an acceptance of the buyer’s offer then UCC § 2-206(1)(b) is inapplicable. Although Easterbrook did not explicitly develop this line of reasoning, his opinion leaves little doubt that he believes consumers who make telephone orders usually understand that the seller may include additional contract terms in the packaging and that the seller’s shipment of the goods does not therefore constitute an acceptance of the buyer’s offer.¹⁹⁵ Whether the circumstances of a telephone order “unambiguously indicate” that the seller’s shipment of the goods does not operate as an acceptance is another matter. Most of Easterbrook’s critics presumably believe there is sufficient ambiguity to make the qualification inapplicable.

If this qualification to UCC § 2-206(1)(b) does not apply, then the contract was formed when Gateway shipped the computer and it did not include the terms that Gateway included inside the packaging, such as the arbitration clause. Under Article 2, these were additional terms in an acceptance, subject to UCC § 2-207. UCC § 2-207

¹⁹⁴ U.C.C. § 2-206(1)(b) (2005).

¹⁹⁵ Judge Easterbrook clearly thought that the Hills knew there would be additional terms inside the box. As he explained, “the Hills knew before they ordered the computer that the carton would include some important terms...”. *Hill v. Gateway*, 105 F.3d at 1150.

provides two rules for such situations: the “last shot” rule in UCC § 2-207(2) and the “knock out” rule in UCC § 2-207(3).¹⁹⁶ This has created some confusion and controversy about when the particular rules are meant to apply. Official comment 1 explains that UCC § 2-207 is meant to apply in two situations: the first in which an agreement has been reached but one or both parties send memoranda that include terms in addition to those agreed upon, and the second in which the parties do not clearly reach an agreement on any terms but agree to transact, and then exchange memoranda -- or “acknowledgements” -- that contain different terms.¹⁹⁷ The classic scenario for the second situation is the one in which the parties exchange standard forms. According to official comment 2, UCC § 2-207(2) -- the “last shot” rule -- applies to the first situation - - the one in which an agreement has been closed -- and, by implication, section 2-207(3) - - the “knock out” rule -- applies to situations in which an agreement on terms has not been reached, such as in the case of an exchange of standard forms.¹⁹⁸

Setting Judge Easterbrook’s holding aside, and supposing that Article 2 as construed here applies instead, it is not precisely clear which of the two rules should apply in the *Hill v. Gateway* situation. The parties did not dicker or negotiate over the terms of their agreement, but a contract appears to have been formed nonetheless under

¹⁹⁶ Under the “last shot” rule, in a contract between merchants additional terms are automatically added to the contract unless the offeror limited the terms of acceptance to the terms of the offer, or they would materially alter the contract, or the offeror objects within a reasonable time. Under the “knock out” rule, the terms of the contract consist of those terms on which the parties writings agree plus any additional terms implied by Article 2. See GILLETTE & WALT, *supra* note 147 at 59-66 for an explanation.

¹⁹⁷ U.C.C. § 2-207 cmt 1 (2005).

¹⁹⁸ U.C.C. § 2-207 cmt 2 (2005).

UCC § 2-206(1)(b). Since the parties did not exchange standard forms, the case for applying the last shot rule may seem the strongest. Nonetheless, official comment 7 states that “in many cases, as where goods are shipped, accepted and paid for before any dispute arises, there is no question of whether a contract has been made...[and]....the only question is what terms are included....”.¹⁹⁹ According to official comment 7, in such a case “subsection (3) [the knock out rule] furnishes the governing rule.”²⁰⁰ Regardless of which rule applies, however, the outcome would appear to favor the Hills.

Under the last shot rule, the terms of their agreement were defined at the time Gateway shipped the computer. The contract included all of the default rules of Article 2, since the parties did not agree to any special contract terms of their own. Under UCC § 2-207(2) the terms on the writings inside the box should have been construed as proposals for addition to the contract.²⁰¹ Between merchants such proposals automatically become part of the contract unless the offer expressly limit’s the terms of acceptance to the terms of the offer, or they materially alter it, or the party receiving them gives notice of objection to them within a reasonable time.²⁰² The Hills were clearly consumers and not merchants.²⁰³ UCC § 2-207(2) does not state any conditions under which the proposed additional terms become part of the contract if the recipient is not a merchant. Presumably they do not become part of the contract without the recipient’s

¹⁹⁹ U.C.C. § 2-207 cmt 7 (2005).

²⁰⁰ U.C.C. § 2-207 cmt 7 (2005).

²⁰¹ U.C.C. § 2-207(2) (2005).

²⁰² U.C.C. § 2-207(2) (2005).

²⁰³ U.C.C. § 2-104(1) defines a merchant as “a person who deals in goods of the kind or otherwise holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction...”.

consent. Since the Hills did not consent to any of the additional terms, including the arbitration clause, the additional terms could not have become part of the contract.

Under the knock out rule of UCC § 2-207(3) the contract would include all those terms on which the writings of the parties agreed plus any supplemental terms included under other provisions of Article 2.²⁰⁴ Since the Hills did not provide a writing, none of the terms in Gateway's writings could have been included in the contract unless they would also have been included by other provisions of Article 2. Since none of the other provisions of Article 2 would have implied an arbitration clause, the arbitration clause clearly could not have become part of the contract under the knock out rule. It is doubtful whether any of the other terms in Gateway's writings could have become part of the contract either. The terms of the contract could only have been those provided by the default rules of Article 2.

Easterbrook has been widely criticized by scholars who argue that he did not follow the UCC.²⁰⁵ Indeed, there seems little doubt that his ruling was motivated primarily by policy considerations and that he relied on the *ProCD* precedent to circumvent the implications of Article 2. This is regrettable because it has only confounded the effect of his ruling and compromised his objective, which appears to have been to resolve the conundrum raised by "terms later" contracts for the sale of goods.²⁰⁶ Easterbrook clearly felt that utilitarian considerations favored a change in the rules, and

²⁰⁴ U.C.C § 2-207(3) (2005).

²⁰⁵ See e.g. Bern, *supra* note 160 and Lawrence, *supra* note 160.

²⁰⁶ As Easterbrook noted in his opinion, these are quite common in contracts for services. As he explained, "Payment preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors." *Hill v. Gateway*, 105 F.3d at 1149.

there is good reason to believe he is right (although these are not the only considerations). Requiring sellers to provide notice of the additional terms at the time of buyers' telephone orders would raise significant evidentiary problems.²⁰⁷ How would sellers prove that sufficient notice was given in every telephone order? Would every telephone order have to be recorded and stored until the statute of limitations on any potential cause of action expired? Would such recordings be admissible?

In spite of all the criticisms of Easterbrook's opinion, it is not clear that adhering to a strict interpretation of UCC § 2-206(1)(b) will ultimately prove to be in the best interests of consumers. Forcing sellers to jump through hoops to contract around Article 2's default rules or to simply forego arbitration clauses and other contractual arrangements that reduce their expected legal costs will result in higher prices for goods purchased through telephone orders. We can only speculate, but it seems reasonable to guess that most consumers, if given the choice, would probably opt to subject themselves to arbitration clauses and other reasonable limitations on their contract rights if it meant getting the goods for lower prices. After all, how many manufacturers offer "full warranties" under the Magnusson-Moss Warranty Act because consumers prefer to them to limited warranties?²⁰⁸ How many consumers in general decline to make purchases because they object to limited warranties and arbitration clauses?²⁰⁹ We do not have any

²⁰⁷ See the discussion *supra* p. 50.

²⁰⁸ According to Honnold & Reitz, *supra* note 183 at 289, "The hope that most manufacturers of consumer durable goods would offer FULL WARRANTIES has proven to be unfounded."

²⁰⁹ See Christine Jolls & Cass R. Sunstein, *Debiasing Through Law* 35 J.LEGAL STUD. 199, 206-225 (2006) for a discussion of consumers' "optimism bias" and various legal strategies for addressing the problems it raises.

systematic evidence, but casual observation suggests that most consumers are not willing to pay much for contract rights with uncertain or unknown values. Of course, this may reflect the limits on their rationality, and to the extent that it does, consumer protections of some kind could be necessary to vindicate their rights and enhance the public welfare. But those protections could take some form other than cumbersome constraints on sellers' efforts to service telephone orders.²¹⁰

The real problem with *Hill v. Gateway* seems to arise not from the rule that Easterbrook fashioned, but from the cavalier way it dispenses with some of the values that are deeply embedded in modern contract law. Most scholars and other commentators would probably not object to a delay in the timing of contract formation if consumers were made aware that additional terms they had not already explicitly assented to were going to be added to their contracts unless they returned the goods within some reasonable time. Indeed, some other courts have rejected arbitration clauses that sellers included on writings inside the packaging of their goods on the grounds that the terms had not been assented to.²¹¹ Judge Easterbrook seems to believe that consumers commonly understand that important contract terms are included in writings on or inside the packaging of goods; other scholars seem to disagree. The question could be resolved through an empirical study, but that would probably be beside the point. The real issue is whether consumers need to be protected from inadvertently waiving their Article 2 rights.

²¹⁰ See *Id.* for a discussion of alternative approaches to consumer protection.

²¹¹ See e.g. *Brower v. Gateway 2000, Inc.* 676 N.Y.S.2d 569 (App. Div 1998) (Gateway's arbitration clause held to be unconscionable) or *Defontes v. Dell Computers Corp.*, 52 U.C.C. Rep. Serv. 2d 795 (R.I. Super. 2004) (Dell's arbitration clause not enforced because the buyer had not assented to it).

Setting the controversy over the merits of his ruling aside, Judge Easterbrook clearly sought to revise the law with his holding. His efforts have been at best a mixed success. Although *Hill v. Gateway* has been followed in some cases,²¹² it has been rejected in others.²¹³ As things stand, the law governing the matter in most jurisdictions is uncertain. The uncertainty arises not because Article 2 is unclear, or because state courts have independently shown an inclination to modify it through liberal interpretations, rather, it is unclear because the Seventh Circuit has provided a controversial ruling on a question of state law where the state law was perfectly clear in a conscious attempt to revise the law.

C. Failures of Limited Remedies and Exclusions of Consequential Damages

Most sophisticated manufacturers attempt to limit their liabilities for breach of both express and implied warranties.²¹⁴ They do so by making as few warranties as possible, and by limiting buyers' rights to damages for breaches of any warranties they do make. The UCC regulates sellers' attempts to exclude or modify express and implied warranties in UCC § 2-316.²¹⁵ It also regulates their attempts to exclude or limit damages

²¹² See *Filius v. Gateway 2000, Inc.*, 197 WL 33814599 (E.D. Mich. 1998), and *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (App. Div. 1998).

²¹³ See *Klocek v. Gateway 2000, Inc.*, 104 F.Supp.2d 1332 (D. Kan. 2000), and *Defontes v. Dell Computers Corp.*, 52 U.C.C. Rep. Serv. 2d 795 (R.I. Super. 2004).

²¹⁴ HONNOLD & REITZ, *supra* note 183 at 202.

²¹⁵ U.C.C. § 2-316(1) (2005) precludes sellers from excluding express warranties once made ("negation or limitation is inoperative" to the extent that it cannot reasonably be interpreted as consistent with the wording or conduct by which express warranties were created), and U.C.C. § 2-316(2) (2005) states that

in UCC § 2-379.²¹⁶ Most sophisticated manufacturers attempt to make as few express warranties as they can,²¹⁷ and to exclude all implied warranties of merchantability and fitness.²¹⁸ They also commonly avail themselves of the provisions of UCC § 2-719(1) to offer a limited remedy to repair or replace the goods in substitution for the remedies of the UCC.²¹⁹ In addition, to the extent that they can, they typically also exclude all consequential damages.²²⁰

“to exclude or modify the implied warranty of merchantability ...the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous.”

²¹⁶ U.C.C. § 2-719(2) (2005) states that “Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.” As official comment 1 explains, “under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.”

²¹⁷ Consistent, of course, with their marketing objectives for their products. Once made, express warranties cannot be disclaimed (U.C.C. § 2-316(1) (2005)), so it behooves sellers to avoid making any superfluous warranties..

²¹⁸ This is usually done in language that complies with U.C.C. §2-316(2), although U.C.C. §2-316(3) provides some useful alternatives.

²¹⁹ U.C.C. § 2-719(1)(a) (2005) allows a limited remedy clause “in addition to or in substitution” for the default remedies under Article 2; U.C.C. § 2-719(1)(b) (2005) states that the limited remedy is presumed to “optional” unless “expressly agreed to be exclusive.” Needless to say, most sophisticated manufacturers include wording in the writings to ensure that the limited remedies will be exclusive.

²²⁰ U.C.C. § 2-719(3) (2005) allows the limitation or exclusion of consequential damages unless “the limitation or exclusion is unconscionable.”

This has created some confusion. Courts have struggled over the appropriate interpretation of Article 2 in cases where sellers' attempts to limit their buyers' remedies fail to satisfy the regulatory provisions of UCC § 2-719.²²¹ According to UCC § 2-719(2), when a limited remedy fails of its essential purpose, the buyer has recourse to all the default remedies under Article 2.²²² Of course, these include expectation damages under UCC § 2-714²²³ as well as incidental and consequential damages under UCC § 2-715.²²⁴ But UCC § 2-719 also allows sellers to exclude or limit a buyer's right to consequential damages. The only regulations on the seller's right to exclude consequential damages are that the exclusion may not be unconscionable²²⁵ and that consequential damages may not be excluded or limited for personal injury in the case where the buyer is a consumer.²²⁶ Where the buyer is a merchant, therefore, the only

²²¹ See the discussion in GILLETTE & WALT, *supra* note 147 at 387-390.

²²² As suggested in official comment 1, the test is whether the limited remedy "fails in its purpose or operates to deprive either party of the substantial value of the bargain." U.C.C. § 2-719, cmt. 1 (2005).

²²³ U.C.C. § 2-714(2) (2005) states that "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted". While the interpretation is not transparent, this apparently includes damages applicable under the conventional doctrine of expectancy or expectation damages. See GILLETTE & WALT, *supra* note 147 at 349-354.

²²⁴ U.C.C. § 2-715(1) (2005) authorizes incidental damages and U.C.C. § 2-715(2) (2005) authorizes consequential damages.

²²⁵ Of course, since the doctrine of unconscionability seems to apply to all contract clauses under 2-302 this additional prohibition in 2-719 may be redundant.

²²⁶ U.C.C. § 2-719(3) (2005) states that limitation of consequential damages "for injury to the person in the case of consumer goods in prima facie unconscionable".

regulation is that the exclusion may not be unconscionable, and since courts are reluctant to apply the doctrine of unconscionability when invoked by a merchant,²²⁷ Article 2 in effect places very little constraint on sellers' ability to exclude consequential damages. Confusion arises, however, when sellers' limited remedies fail of their essential purpose and the seller has also sought to exclude consequential damages in a separate and distinct contract clause.

Does the provision in UCC § 2-719(2) which provides the buyer with recourse to all the default remedies in Article 2 trump the additional clause purporting to exclude consequential damages, or does the exclusion of consequential damages clause stand independently of whether the limitation of remedy fails? The early case law held that the failure of the limitation of remedy nullified the seller's attempt to exclude consequential damages.²²⁸ This was not a particularly convincing interpretation. If the seller's limitation of remedy does not fail of its essential purpose then that alone will be sufficient to deny the buyer any consequential damages. Whether the contract includes an additional clause purporting to exclude consequential damages will be irrelevant. If the failure of the seller's limitation of remedy clause nullifies the seller's attempt to exclude consequential damages then the additional clause purporting to exclude consequential damages is again irrelevant. In other words, under this early reading of the Code, an

²²⁷ The doctrine of unconscionability is usually applied through a two prong test, the first of which inquires as to whether there was any procedural abuse and the second whether there was any substantive abuse. The procedural abuse prong looks for a variety of indicia, including whether there was any disparity in the bargaining capacities of the parties. Merchants are usually presumed to be relatively sophisticated in bargaining. See GILLETTE & WALT, *supra* note 147 at 176-183 for a discussion.

²²⁸ See *Id.* at 387 for a discussion.

additional contract clause purporting to exclude consequential damages under UCC § 2-719(3) would have been irrelevant if the seller had also sought to limit the buyer's remedy under UCC § 2-719(1).

Since rational parties would not normally draft irrelevant contract terms, this is not a particularly compelling interpretation of the Code. A more convincing interpretation, and the one that is dominant in the recent case law,²²⁹ would give an independent effect to any contract clause that sought to exclude consequential damages. Under this approach, whether the exclusion of consequential damages was effective would be completely independent of whether the limitation of remedy failed of its essential purpose. Thus, the limitation of remedy would be effective as long as it did not fail of its essential purpose, and as long as it was effective, the exclusion of consequential damages clause would be irrelevant. But if the limitation of remedy did fail of its essential purpose the exclusion of consequential damages clause would remain effective unless a court determined that it also failed for independent reasons.²³⁰ The clause excluding consequential damages would provide an additional layer of protection for the seller and would therefore at least serve an intelligible purpose. Since a contract interpretation that imputes an intelligible purpose to contract terms seems preferable to one that does not, this seems the more compelling approach.

In a recent line of cases, however, the Ninth Circuit has confounded the question by adopting a third approach. To begin with, in *S.M. Wilson & Co. v. Smith Int'l., Inc.*,²³¹

²²⁹ *Id.*

²³⁰ In other words, it would remain effective as long as it was not unconscionable or it did not apply to consequential damages for personal injuries suffered by a consumer. U.C.C. § 2-719(3).

²³¹ *S.M. Wilson & Co. v. Smith Int'l., Inc.*, 587 F.2d 1363.

the Ninth Circuit predicted that California courts would treat the failure of a limited remedy clause and the effectiveness of an exclusion of consequential damages clause as independent questions²³² (there were no state court precedents to follow), and upheld an exclusion of consequential damages clause even though the limitation of remedy clause failed of its essential purpose.²³³ This in itself was no great departure from the drift of the case law. The court buttressed the rationale for its holding, however, by stating that “The default of the seller is not so total and fundamental as to require that its consequential damage limitation be expunged from the contract.”²³⁴ It may well have been true that Smith’s default was not “total and fundamental”, but whatever that standard might mean, it does not derive from Article 2. The Ninth Circuit seemed to suggest that if Smith’s breach had been “total and fundamental” this would have justified expunging the exclusion of consequential damages from the contract regardless of the UCC.

Since this was merely dicta, it did not by itself mark a departure from the dominant approach, but in hindsight it foreshadowed a drift in Court’s jurisprudence. The Ninth Circuit subsequently revisited the question in *Fiorito Bros., Inc. v. Freuhauf Corp.*, a case that arose under Washington law.²³⁵ The buyer in that case had contracted for the purchase of thirteen dump truck bodies.²³⁶ The seller had created an express

²³² As the court explained, “Consequential damages were assigned to the buyer, Wilson.... The seller Smith did not ignore his obligation to repair; he simply was unable to perform it. This is not enough to require the seller to absorb losses the buyer plainly agreed to bear.” *Id.* at 1375.

²³³ *Id.*

²³⁴ *Id.*

²³⁵ *Fiorito Bros., Inc. v. Freuhauf Corp.*, 747 F.2d 1309 (9th Cir. 1984).

²³⁶ *Id.* at 1310.

warranty that the truck bodies would be suitable for the purpose of transporting wet concrete.²³⁷ When that turned out not to be true, the seller made no attempt to repair or replace them. The question of the effect of the failure of the limitation of remedy clause on the exclusion of consequential damages went to the Ninth Circuit. The Ninth Circuit reiterated its adherence to the “case-by-case” approach to determining whether the two clauses were inseparable parts of the risk-allocation or independent,²³⁸ but this time held that the exclusion of consequential damages was ineffective.²³⁹ The Ninth Circuit quoted directly from the trial court’s opinion: “It cannot be maintained that it was the parties intention that Defendant be enabled to avoid all consequential liability for breach by first agreeing to an alternative remedy provision designed to avoid consequential harms, and then scuttling that alternative through its recalcitrance in honoring the agreement.”²⁴⁰

Setting aside any questions about whether a limitation of remedy clause is *intended* to prevent consequential harms,²⁴¹ the most striking implication of this quotation is that the Court apparently did not read the exclusion of consequential damages clause as separate and distinct from the limitation of remedy clause. Of course, if the exclusion of consequential damages is not made in a clause separate and distinct from the limitation of

²³⁷ *Id.*

²³⁸ *Id.* at 1314-1315.

²³⁹ *Id.* at 1315.

²⁴⁰ *Id.*

²⁴¹ It seems clear that it is not directly intended to do so. Rather, it is directly intended to limit the buyer’s remedy for breaches (and the seller’s exposure to liabilities) regardless of whether consequential harms were incurred. Of course, a buyer may reasonably believe that if the limited remedy serves its essential purpose there will be no consequential harms.

remedy clause then it cannot stand as a separate clause of the contract. Since there is no other independent clause limiting the buyer's damages, the failure of the limitation of remedy clause is then tantamount to the failure of the limitation on the buyer's right to consequential damages. Perhaps viewed in this light, *Fiorito* did not mark such a drastic departure from the case law either.

The Ninth Circuit revisited the question yet again, however, in *Milgard Tempering, Inc. v. Selas Corp.*²⁴² This time its treatment of the problem clearly did mark a departure from the dominant approach. In *Milgard* the buyer transacted for the design and delivery of a tempering furnace through what the Court described as a “carefully negotiated contract.”²⁴³ The seller, Selas, regarded the design of the furnace as “experimental” but agreed to deliver it for what the Court clearly regarded as a hefty price of \$1.45 million.²⁴⁴ The contract also included some timeliness provisions. When Selas was unable to meet these, the parties were initially able to settle out of court, but when Selas failed to perform within the additional period provided under the settlement agreement the case ensued.²⁴⁵ At trial Selas was initially granted a summary judgment, but this was overturned on appeal.²⁴⁶ On remand the trial court held that the limited remedy clause failed of its essential purpose and that Selas' default was fundamental

²⁴² *Milgard Tempering, Inc. v. Selas Corp.*, 902 F.2d 703 (9th Cir. 1990).

²⁴³ *Id.* at 705.

²⁴⁴ *Id.*

²⁴⁵ *Id.* at 706.

²⁴⁶ *Milgard Tempering, Inc. v. Selas Corp. of America*, 761 F.2d 553 (9th Cir. 1985).

enough to nullify the exclusion of consequential damages.²⁴⁷ Milgard was awarded over \$1 million in net damages.²⁴⁸

Selas appealed on two grounds: first, that the trial court erred in holding that the limited remedy clause failed of its essential purpose, and second, that the trial court erred in holding that the failure of the limited remedy invalidated the exclusion of consequential damages.²⁴⁹ Judge Hall upheld the trial court on the failure of the limited remedy clause rather summarily and then addressed the question of consequential damages at greater length. He rejected the notion that a characterization of the seller's breach as "total and fundamental" had any bearing on the effectiveness of an exclusion of consequential damages clause and reiterated the Court's aversion to "talismanic analysis."²⁵⁰ As he explained, the appropriate test was "whether Selas' default caused a loss which was not part of the bargained-for allocation of risk".²⁵¹ Indeed, this was the test that the trial court had actually applied, and Judge Hall therefore also upheld the trial court's "decision to lift the cap on consequential damages."²⁵² As he explained, "Milgard did not agree to pay \$1.45 million in order to participate in a science experiment."²⁵³

²⁴⁷ *Milgard*, 902 F.2d at 709.

²⁴⁸ *Id.*

²⁴⁹ *Id.*

²⁵⁰ The Ninth Circuit had expressed its distaste for "talismanic analysis" the first time it addressed the case. in *Milgard*, 761 F.2d at 556.

²⁵¹ *Milgard*, 902 F.2d at 709.

²⁵² *Id.*

²⁵³ *Id.*

Here Judge Hall not only departed from the drift of the case law, he comes close to contradicting some of the fundamental principles of modern contract law. The opinion reprints both the limited remedy and the exclusion of consequential damages clauses, which were contained in the same paragraph of the writing. It is instructive to reprint this paragraph here.²⁵⁴

In the event of a breach of any warranty, express implied or statutory, or in the even the equipment is found to be defective in workmanship or material or fails to conform to the specifications thereof, [Selas] liability shall be limited to the repair or replacement of such equipment as is found to be defective or non-conforming, provided that written notice of any such defect or non-conformity must be given to Selas within 1 year from the date of acceptance, or 15 months from completion of shipment, whichever first occurs. In the event that acceptance is delayed through the fault of Selas, then the Selas 1 year warranty shall be applicable and shall not begin until the date of acceptance. Selas assumes no liability for no [sic] consequential or incidental damages of any kind (including fire or explosion in the starting, testing, or subsequent operation of the equipment), and the Purchaser assumes all liability for the consequences of its use or misuse by the Purchaser or his employees. In no event shall Selas be liable for damages resulting from the non-operation of Purchaser's plant, loss of product, raw materials, or production as a result of the use, misuse or inability to use the equipment covered by this proposal....

A plain reading of this paragraph clearly indicates that the limitation of remedy and exclusion of consequential damages clauses were separate and distinct. The limitation of remedy is contained in the first sentence; the exclusion of consequential damages is contained in the subsequent two sentences. In fact, the second sentence excludes consequential damages associated with the use or misuse of the furnace, and the

²⁵⁴ *Id.* at 707

third sentence excludes any damages associated with the buyer's inability to use the furnace. The damages that Milgard incurred consisted primarily of lost profits as a result of its inability to use the furnace.²⁵⁵ These damages should have been excluded by the third sentence. The wording was clear that "In no event" should Selas have been liable for damages resulting from Milgard's inability to use the furnace.²⁵⁶ Presumably, that was meant to include the event of the limited remedy failing of its essential purpose. Together with the fact that this third sentence is separated from the limitation of remedy clause by the second sentence, the wording clearly implies that the exclusion of consequential damages was separate and distinct from the limitation of remedy and intended to provide Selas with an additional layer of protection.

Judge Hall nonetheless nullified the effect of this exclusion of damages on the grounds that it had not been bargained-for.²⁵⁷ A clear clause in a writing is normally evidence of what the parties had bargained-for, especially when the court characterizes the contract as one that was "carefully negotiated."²⁵⁸ In this case, however, Judge Hall looked to Milgard's consideration – a price of \$1.45 million – and inferred that the exclusion of consequential damages was not part of the bargain. Although the inclusion of a clause limiting the buyer's right to damages in a contract with such a high price might be considered so grossly unfair as to shock a court's conscience, this by itself could only satisfy one prong of the test for unconscionability.²⁵⁹ For the unconscionability

²⁵⁵ *Id.* at 709.

²⁵⁶ *Id.* at 707.

²⁵⁷ *Id.* at 709.

²⁵⁸ *Id.* at 705.

²⁵⁹ See the discussion *supra* note 227.

doctrine to apply there must also have been some procedural abuse in the negotiation of the contract that exposed the party to an unfair surprise.²⁶⁰ Since the court acknowledged that the contract in this case was “carefully negotiated”²⁶¹ that could hardly have been the case.

Judge Hall seemed to believe that Milgard could not possibly have agreed to such a sweeping exclusion of consequential damages. As he put it, Milgard did not agree to pay \$1.45 million for a “science experiment.”²⁶² But here Judge Hall comes very close to contradicting one of the fundamental principles of modern contract law, alternatively known as the “adequacy doctrine” or the “peppercorn theory.” Under the peppercorn theory²⁶³ courts do not inquire into the adequacy of consideration in determining whether there is an enforceable contract; the mere fact of consideration itself is sufficient.²⁶⁴ In *Milgard*, Judge Hall looks to the buyer’s consideration – a price of \$1.45 million – as evidence of what the buyer had bargained-for and concludes that it must have been more than a furnace with a limited remedy and no consequential damages regardless of whether the limited remedy failed of its essential purpose. But the parties’ writing clearly

²⁶⁰ As official comment 1 to U.C.C. § 2-302 explains, “The principle is one of the prevention of oppression and unfair surprise.”

²⁶¹ *Milgard*, 902 F.2d at 705.

²⁶² *Milgard*, 902 F.2d at 709.

²⁶³ The term derives from the common law maxim that “even something as trifling in value as a peppercorn could serve as consideration for a bargain.” ROBERT E. SCOTT & DOUGLASS L. LESLIE, *CONTRACT LAW AND THEORY* 127 (1993).

²⁶⁴ *Batsakis v. Demotsis* 226 S.W.2d 673 (Court of Civil Appeals of Texas, 1948) is probably the most famous case in which the doctrine is invoked. As the *Batsakis* court held “Mere inadequacy of consideration will not void a contract.” *Id.* at 675.

included a separate and distinct clause excluding consequential damages. Judge Hall looks to Milgard's consideration – primarily the contract price – as evidence of Selas' consideration – whether Selas was to provide consequential damages in the event its limited remedy failed. In treating Milgard's consideration as evidence that Selas' consideration must have been more than merely a furnace with a limited remedy and no consequential damages, even though there was a separate and distinct contract clause that clearly excluded consequential damages, Judge Hall came very close to holding that Selas' consideration under the contract was inadequate.

Some commentators have written favorably about this approach to the problem.²⁶⁵ While there is nothing in principle wrong with a court looking to the parties' consideration as a means of determining the scope of their bargain, Judge Hall's opinion in *Milgard* goes further. It looks to the buyer's consideration to trump a separate and distinct clause in the writing excluding consequential damages. In this regard, it comes close to making a judgment about the adequacy of the seller's consideration. To put the matter in perspective, could Judge Hall have held that the contract price was not in fact \$1.45 million, in spite of the clear evidence otherwise, simply because the writing included a clause excluding consequential damages and because no sensible buyer would have paid that much for the furnace without the right to consequential damages in the event that the limited remedy failed? The only circumstance that prevents Judge Hall's decision from blatantly violating the adequacy of consideration doctrine is some lingering doubt about whether the clause excluding consequential damages was truly understood by the buyer to be separate and distinct from the limited remedy clause.

²⁶⁵ See e.g. GILLETTE & WALT, *supra* note 147 at 388.

Fortunately, Judge Hall's decision has not been widely followed.²⁶⁶ Nonetheless, it injects some additional uncertainty into many commercial sales transactions. Sellers who wish to provide themselves with a layer of protection against consequential damages claims beyond the one provided by a limited remedy clause may have difficulty in doing so. Writing a separate and distinct clause that clearly excludes consequential damages may not be enough. In the event of a dispute a court may decide to follow the Ninth Circuit's precedent in *Milgard*, and hold that the buyer's consideration is large enough to trump a plain reading of the writing.

D. Summary

These three cases offer concrete examples of how federal courts in three different Circuits have used their discretion in conscious attempts to reinterpret and revise modern sales law. In *Advent Systems* Judge Weis of the Third Circuit held that computer software was a good within the meaning of Article 2 even though the question was not directly raised by the case; he thus sought to bring within the scope of the UCC a wide range of transactions in computer information that might otherwise have been governed

²⁶⁶ *Id.* Although some other courts have purported to follow a similar "case-by-case" approach (see, e.g., *Gilbert Waters v. Massey-Ferguson, Inc.* 775 F.2d (4th Cir. 1985), and *V-M Corporation v. Bernard Distributing Company* 447 F.2d 864 (7th Cir. 1971), a careful reading of these cases indicates that neither of them relied on the size of the buyer's consideration to trump a separate and distinct clause excluding consequential damages. Some courts have clearly rejected the *Milgard* approach (see, e.g., *The Golden Reward Mining Company v. Jervis Webb Company* 772 F.Supp. 1118 (C.C.W.D. SD 1991), and *Jim Pierce and Karen Pierce v. Catalina Yachts, Inc.* 2 P.3d 618 (Alaska 2000)).

by state common law.²⁶⁷ In *Hill v. Gateway* Judge Easterbrook of the Seventh Circuit followed a dubious precedent instead of the letter of Article 2 in a bold attempt to revise the rules of contract formation and legitimize “terms later” contracts in sales transactions.²⁶⁸ And in *Milgard*, Judge Hall of the Ninth Circuit stretched the “case-by-case” approach to determining the effectiveness of damage exclusion clauses when limited remedy clauses fail so far that he came very close to contradicting the adequacy of consideration doctrine.²⁶⁹ In each case the court based its holding on policy considerations rather than state legal authorities or predictions about how the state supreme court would rule. And in each case one wonders whether a state court would have felt emboldened or motivated to render a similar holding in the face of the same questions.

In *Advent Systems* the Third Circuit overruled the district court’s decision to apply Pennsylvania common law instead of Article 2.²⁷⁰ Judge Weis looked to the language used in the writing, the manner of billing, and the nature of the items that had been contracted for in a manner consistent with the predominant factor test.²⁷¹ He could have easily held that Article 2 applied on this basis alone without also holding that computer software is a good. Indeed, one wonders whether a Pennsylvania Superior Court would have done the same.²⁷² Since the holding was completely unnecessary to the disposition

²⁶⁷ *Advent Systems*, 925 F.2d at 676.

²⁶⁸ *Hill v. Gateway*, 105 F.3d at 1150.

²⁶⁹ *Milgard*, 902 F.2d at 709. See also the discussion *supra* part III.A.

²⁷⁰ *Advent Systems*, 925 F.2d at 676.

²⁷¹ *Id.* at 674.

²⁷² For an overview of the Pennsylvania state court system see <http://www.courts.state.pa.us/>.

of the case, any state court judge should have feared being overruled on the matter by the state supreme court. Moreover, one wonders whether any state court judge would have had the same motivation to extend the scope of Article 2. Was the volume of contract cases involving computer software in Pennsylvania large enough to have made the matter so important? Judge Weis purported to apply Pennsylvania law to the case, but it is clear that he looked well beyond Pennsylvania's borders when making his utilitarian calculations.

Similar observations can be made about *Hill v. Gateway* and *Milgard*. In *Hill v. Gateway* Judge Easterbrook declined to follow Article 2, even though it seemed to offer a clear answer to the question raised by the case.²⁷³ Would any judge on the Appellate Court of Illinois have ignored the state statute in favor of a Seventh Circuit precedent that clearly also ignored the state statute?²⁷⁴ That is difficult to imagine. Would any judge on the Appellate Court of Illinois -- subject to reelection every six years²⁷⁵ -- have disregarded an Illinois statute to take the side of a corporate computer manufacturer against a consumer? That is also difficult to imagine. It is perhaps easier to imagine how a judge on the Washington Court of Appeals²⁷⁶ could have relied on the size of the contract price to invalidate an exclusion of consequential damages clause, as Judge Hall did in *Milgard*.²⁷⁷ But it is still not easy. Judge Hall's holding in *Milgard* developed a line of jurisprudence that the Ninth Circuit began in *S.M. Wilson & Co.* and continued in

²⁷³ *Hill v. Gateway*, 105 F.3d at 1149.

²⁷⁴ For an overview of the Illinois state court system see <http://www.state.il.us/COURT/>.

²⁷⁵ *Id.*

²⁷⁶ For an overview of the Washington state court system see <http://www.courts.wa.gov/>.

²⁷⁷ *Milgard*, 902 F.2d at 709.

Fiorito.²⁷⁸ In *S.M. Wilson & Co.* the Ninth Circuit purported to apply California law and in *Fiorito* it purported to apply Washington law.²⁷⁹ The Ninth Circuit thus predicted that the state supreme courts in both California and Washington would depart from the dominant approach in favor of a “case-by-case” analysis. How plausible is that? Judge Hall’s deference to Washington law in *Milgard* was obviously no more than a formality; the Ninth Circuit was clearly developing its own jurisprudence.

All three cases illustrate how the federal courts have often used their discretion in conscious attempts to reinterpret and revise modern sales law. Indeed, they illustrate how little regard the federal courts have sometimes paid to state legal authorities or their obligation to predict how the state supreme court would rule on the same question in sales law cases. Instead, as the examples suggest, they have often looked to broader policy considerations in attempts to fashion rules that are not only consonant with their utilitarian calculations, but will transcend jurisdictional boundaries. In this regard, they are behaving much as if they were still in the *Swift v. Tyson* era, when the federal courts commonly appealed to the law of the merchant in attempts to construct a body of general commercial law that cohered with the underlying principles of commerce.

CONCLUSION

Almost seventy years after the Supreme Court sought to rationalize the American system of judicial federalism in *Erie*, sales law remains trapped in a pattern more reminiscent of the *Swift v. Tyson* era. The extraordinarily wide separation of powers in

²⁷⁸ *Id.* at 708.

²⁷⁹ *Id.*

the NCCUSL-ALI uniform law-making process has entrenched Article 2 of the UCC in the status quo. Concurrently, an imbalance between the federal and state courts in the American system of judicial federalism has conferred an unusually wide range of discretion over state commercial law on the federal courts. Ironically, therefore, state sales statutes are being reinterpreted and revised by the federal courts rather than the state legislatures or state courts. The federal courts are thus the most important source of innovation and experimentation in modern American sales law, but the role they play is not entirely consistent with modern notions of democracy and judicial restraint. Moreover, it is debatable whether they have brought much rationality and coherence to the law or simply injected uncertainty and disharmony instead.

At this point it appears that the pattern will persist. Thus, the federal courts will probably remain the most important source of new developments in sales law for some time to come. But it is doubtful whether these developments will converge and therefore whether sales law will remain uniform. Indeed, the converse seems far more likely. Neither federal nor state courts have rushed to follow cases such as *Advent Systems*, *Hill v. Gateway*, and *Milgard*, which have rendered important new holdings on fundamental questions of the law, and it appears unlikely that they will do so anytime soon. It seems inevitable that American sales law will continue to diverge, not only across jurisdictions but further and further away from the rickety framework of Article 2. American sales law therefore will not only continue to devolve into something more akin to the common law, it will remain an area of disjunction in which the federal courts play the dominant role in developing the law, even though the law is still formally within the authority of the states.